The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)
	)
Applications for Consent to the	)
Transfer of Control of Licenses	)
	)
Comcast Corporation and AT&T Corp.,	)
Transferors,	)
To	)
AT&T Comcast Corporation,	)
Transferee	)

PETITION TO DENY
OF

ARIZONA CONSUMERS COUNCIL, ASSOCIATION OF INDEPENDENT VIDEO AND FILMMAKERS, CALPIRG, CENTER FOR DIGITAL DEMOCRACY, CENTER FOR PUBLIC REPRESENTATION, CHICAGO CONSUMER COALITION, CIVIL RIGHTS FORUM ON COMMUNICATIONS POLICY, CITIZEN ACTION OF ILLINOIS, CONSUMER ACTION, CONSUMER ASSISTANCE COUNCIL, CONSUMER FEDERATION OF AMERICA, CONSUMER FRAUD WATCH, CONSUMERS UNITED/MINNESOTANS FOR SAFE FOOD, CONSUMERS UNION, CONSUMERS' VOICE, DEMOCRATIC PROCESS CENTER, EMPIRE STATE CONSUMER ASSOCIATION, FLORIDA CONSUMER ACTION NETWORK, IL (Illinois) PIRG MASSACHUSETTS CONSUMERS COALITION, MASSPIRG, MEDIA ACCESS PROJECT, MERCER COUNTY COMMUNITY ACTION, NATIONAL ALLIANCE FOR MEDIA ARTS AND CULTURE, MONTPIRG, NEW YORK CITIZENS UTILITY BOARD, NC PIRG, NORTH CAROLINA JUSTICE AND COMMUNITY DEVELOPMENT CENTER, OS PIRG (Oregon State), OREGON CITIZENS UTILITY BOARD, TEXAS CONSUMER ASSOCIATION, TEXAS WATCH, UNITED CHURCH OF CHRIST, OFFICE OF COMMUNICATION, INC., US PIRG, VIRGINIA CITIZENS CONSUMER COUNCIL, WASHPIRG, WISCONSIN CONSUMERS LEAGUE

Mark Cooper
Director of Research
CONSUMER FEDERATION OF AMERICA
1424 16th Street, NW
Suite 604
Washington DC
(202) 387-6121

COUNSEL
Harold Feld
Andrew Jay Schwartzman
Cheryl A. Leanza
MEDIA ACCESS PROJECT
1625 K St., NW
Suite 1118
Washington, DC 20006
(202) 232-4300
Counsel for CFA, et al.

April 29, 2002

TABLE OF CONTENTS

SUMMARY

RELIEF REQUESTED

Because Applicants have not met their burden under Sections 214 and 310 of the Communications Act of 1934 and have not proven that grant of the Application would serve the public interest and, in fact, as Petitioners demonstrate, grant of the Application would harm the public interest, the Commission must deny the Application or designate the Application for hearing.

PERSISTENT PROBLEMS OF ABUSIVE MARKET POWER IN THE CABLE INDUSTRY WILL BE EXACERBATED BY THE AT&T/COMCAST MERGER

CONCENTRATION IN THE CABLE INDUSTRY THROUGH MERGERS AND ACQUISITIONS HARMS CONSUMERS AND DOES NOT PROMOTE THE PUBLIC INTEREST

Cable prices have increased by over forty percent – more than two-and-one-half times the rate of inflation – since deregulation of the cable industry in 1996 and monopoly profits of cable owners have more than doubled. The FCC's own analysis shows that the larger the cable operators become and the more regional control they gain, the higher are monthly prices.

PERVASIVE MARKET POWER PROBLEMS AFFLICT THE AT&T/COMCAST MERGER

AT&T and Comcast are dominant distribution entities with monopoly or duopoly markets at the point-of-sale for both multi-channel video programming distribution (MVPD) and broadband Internet access markets. They have engaged in behaviors that frustrate entry in both of these markets. Both AT&T and Comcast are vertically integrated through ownership and joint ventures into content production for local distribution markets and have attempted to preserve and enhance their market power in these markets through foreclosure and discrimination. AT&T/Comcast would be the largest purchaser of content from both video and Internet content producers with greater leverage to pursue anticompetitive and discriminatory behavior.

SATELLITE COMPETITION DOES NOT CONSTRAIN CABLE PRICES AND IS TOO WEAK TO PREVENT THE ABUSE OF CABLE MARKET POWER

The FCC's analysis consistently shows that satellite does not exert a significant competitive effect on cable industry price, quantity or quality. Satellite does not compete in the cable market--it serves a market adjacent to the cable market. Satellite's feeble competitive overlap with cable is likely to become weaker and narrower in the future as cable rolls out its digital bundles of services. The failure of satellite to discipline market power is just the latest in a long series of failures of cross technology competition to end the cable monopoly.

THE FAILURE OF HEAD-TO-HEAD COMPETITION IN THE CABLE INDUSTRY SHOULD NOT BE REWARDED; REJECTING MERGERS CAN STIMULATE COMPETITION

It is legal for AT&T and Comcast to grow by entering enter each other's service territories and competing head-to-head. This head-to-head competition would certainly be in the public interest, but they never try it. They prefer to frustrate competition by expanding their

monopoly size through merger and acquisition. If they were not allowed to merge, they might in fact, compete.

PROMISED CONSUMER BENEFITS OF PAST MERGERS HAVE EITHER FAILED TO MATERIALIZE OR DO NOT REQUIRE MERGERS TO BE ACHIEVED

LOCAL TELEPHONE COMPETITION IS NOT DEPENDENT ON THE MERGER

In the process of approving mergers between regional bell operating companies the FCC has repeatedly rejected the claim that unique expertise must be brought to bear in the local telephone market. The large urban areas that are being acquired and clustered by this merger already enjoy the highest level of competition. Thus, even if there were some reason to believe the merger would increase competition from cable telephony, the impact would take place in those markets that need it least.

UNIQUE EFFICIENCIES CLAIMED FOR THE MERGER ARE DUBIOUS AND EFFICIENCY GAINS ARE NOT LIKELY TO BE PASSED ON TO CONSUMERS BECAUSE OF A LACK OF COMPETITION

Huge size is not necessary to upgrade cable plant and deploy the latest technology. Most of the industry that is far smaller than the post-merger entity has already upgraded to a greater extent. The efficiencies and synergies that AT&T Comcast claim will flow from its huge size and clout in the market will not be translated into consumer benefits. The FCC's own data shows that larger and more regionally powerful multiple system operators (MSOs) charge more.

AN OPEN SET TOP-BOX STANDARD WILL NOT BE ADVANCED BY THE MERGER

AT&T uses an analog set-top box leasing scheme to subsidize its digital set-top box and therefore has a powerful interest to ensure that this market remains closed. Comcast is controlling companies that develop the key intelligence for the emerging multimedia, interactive TV market. Creating a huge purchaser of these components will foreclose competition and allow AT&T/Comcast to dictate standards. Microsoft's relationship with AT&T and Comcast is also a matter of significant concern. AT&T/Comcast have given Microsoft preferential treatment for MSN Internet services and for operating software on set-top boxes.

OPEN COMMUNICATIONS NETWORKS WILL SUFFER A SETBACK AS A RESULT OF THE MERGER

The commercial access that AT&T and Comcast are offering involves the network owners choosing a small number of ISPs who can sell a restrictive set of services; telling the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications; controlling the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and placing independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content. Allowing the merger will only exacerbate the problem because one large closed system is worse than two smaller closed systems. Bringing an ever-larger segment of the market under the control of a single entity steadfastly opposed to non-discriminatory access, the merger weakens the incentive to provide open access.

THE MERGER SHOULD BE REJECTED UNDER BOTH THE ANTITRUST LAWS AND THE COMMUNICATIONS ACT

THE MERGER VIOLATES THE DEPARTMENT OF JUSTICE GUIDELINES

The AT&T Comcast merger increases the level of concentration in regional and national markets by five times the DOJ threshold. It also facilitates the abuse of market power at the local level. It increases the incentive and the ability of the dominant firm to continue its pattern of discrimination against unaffiliated content providers and competing distribution systems and technologies.

THE MERGER VIOLATES THE PUBLIC INTEREST STANDARDS OF THE COMMUNICATIONS ACT

In the AT&T/MediaOne merger AT&T twisted its ownership and management structure to claim a lack of ownership rights, which would run afoul of FCC rules. In other words**,** AT&T **wanted ownership without responsibility.** The proposed AT&T/Comcast merger takes this jumble of ownership mechanisms one step further, by adding a significant element of **responsibility without ownership**. AT&T retains substantial interests in each of the entities that were at issue in 1999, but now it will allow Comcast to run the company with a very small share of ownership. It will also insulate this non-owner management from oversight by the board and the ultimate form of ownership discipline – getting fired – for an extremely long period of time (8 years)**.** The FCC must stop encouraging the companies to skirts its rules by manipulating stock ownership. If it does, AT&T/Comcast would have to divest cable systems with millions of subscribers, or give up the merger.

THE PUBLIC UNDERSTANDS THE DANGER OF MERGERS IN THE MASS MEDIA AND COMMUNICATIONS INDUSTRIES AND OPPOSES THIS MERGER

The numerous consumer, public interest, independent content producers, low income and civil rights groups calling on the Federal Communications Commission to reject this merger reflect a deep sentiment among the public against consolidation in the mass media and communications industries. In response to survey questions the public expresses strong concerns about increasing size and concentration in the media and communications industries, recognizing that they increase price, reduce quality and stifle democratic discourse. With respect to the AT&T/Comcast merger, two thirds of the respondents to one recent survey said that the AT&T/Comcast merger should be denied. The most frequent problem volunteered by respondents with communications industry mergers was the lack of choice and competition (34 percent). The second most frequent problem was higher prices. The sheer size of the companies was a distant third (9 percent).

CONCLUSION

Under any reasonable interpretation of either the Communications Act or the antitrust laws, this merger should be rejected. The failure of the DOJ and the FCC to enforce their rules has resulted in substantial harm to consumers. This merger would make matters much worse, creating a huge national entity with consolidated control over important regional markets. Federal authorities have let consumers down.

RELIEF REQUESTED

Because Applicants have not met their burden under Sections 214 and 310 of the Communications Act of 1934 and have not proved that grant of the Application would serve the public interest and, in fact, as Petitioners demonstrate, grant of the Application would harm the public interest the Commission must deny the Application or designate the Application for hearing.

I. PETITIONERS

The Joint Consumer Petitioners respectfully submit this petition to deny the transfer of licenses and thereby to reject the proposed merger of AT&T Corporation and Comcast Corporation.[1] The Joint Consumer Petitioners represent consumer, public interest, independent content producers, low income and civil rights groups that are active in media and communications policy at the federal, state and local levels.

Arizona Consumers Council

The Arizona Consumers Council was founded in 1966 for the purpose of educating and advocating on the behalf of citizens of the state of Arizona and is the longest, continuously operated state consumer group in the nation.

Association of Independent Video and Filmmakers (AIVF)

AIVF is a 25-year-old professional organization serving international film- and videomakers from documentarians and experimental artists to makers of narrative features. AIVF represents a national membership of 5,000, of whom 4,000 are active independent producers.

AIVF provides services to the field including: informative seminars and networking events, trade discounts and group insurance plans, advocacy for media arts issues, a public resource library, advice and referral support, and publication of books and directories.

CALPIRG

The California Public Interest Research Group (CALPIRG) is California's largest Public Interest Research Group. CALPIRG works to protect consumers and the environment and promote good government. For the past 30 years CALPIRG's Consumer Program has worked to protect consumers from unsafe and unfair services and products.

Center for Digital Democracy (CDD)

The Center for Digital Democracy (CDD) is committed to preserving the openness and diversity of the Internet in the broadband era, and to realizing the full potential of digital communications through the development and encouragement of noncommercial, public interest programming.

Center for Public Representation (CPR)

CPR, founded in 1974 & based in Madison, Wisconsin, is a non-profit advocacy group dedicated to representation of the interests of underrepresented groups of the state, especially as to consumer and health matters, before state and federal legislative and judicial bodies.

Chicago Consumer Coalition

The Chicago Consumer Coalition was founded in l973 and is a network of Local consumer organizations working in a network throughout the Chicago region (SMSA) on a range of issues from housing, banking, food industry, utilities, transportation, eights/measures, etc.

---

[1] "Application and Public Interest Statement," *In the Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (hereafter, Application).

Civil Rights Forum on Communications Policy

The Civil Rights Forum on Communications Policy (CRF), a project of the Tides Center, pursues the twin goals of introducing civil rights principles and advocacy to the implementation of the 1996 Telecommunications Act, and to reframe the discussion over the role of media in our society around the needs of communities and the rights of citizens through education, research, and by forging working links between the civil rights community and others.

Citizen Action of Illinois

Citizen Action/Illinois is the state's largest public interest organization. Building on two decades of experience, Citizen Action/Illinois is a key player in consumer battles at the state and national levels.

Consumer Action

Consumer Action is a non-profit, membership-based organization that was founded in San Francisco in 1971. Since then, Consumer Action has continued to serve consumers nationwide by advancing consumer rights, referring consumers to complaint-handling agencies through our free hotline, publishing educational materials in Chinese, English, Korean, Spanish, Vietnamese and other languages, advocating for consumers in the media and before lawmakers, and comparing prices on credit cards, bank accounts, and long distance services.

Consumer Assistance Council, Inc.

The Consumer Assistance Council, Inc. (CAC) was established in 1972 by local citizens who were concerned with consumer problems on Cape Cod. The primary mission of CAC is to educate buyers and sellers on their rights and to help assure that relations between them are conducted in a fair and equitable manner under the Massachusetts Consumer Protection Act.

CAC is staffed by over twenty volunteer mediators who work with the Attorney General's Consumer Protection office and other state agencies.

Consumer Federation of America

The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.

Consumer Fraud Watch

Consumers United/Minnesotans for Safe Food

Consumers United/MFSF was founded in 1988 to give Minnesota consumers a voice in state and federal policies affecting consumer protection, food safety, health care and personal finance.

Consumers Union

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* (with approximately 4.5 million paid circulation) regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

The Consumers' Voice

Democratic Processes Center

Empire State Consumer Association

Florida Consumer Action Network

The Florida Consumer Action Network is a grassroots organization that empowers citizens to influence public policy by organizing and educating in areas where consumer voices are underrepresented.

IL PIRG

IL PIRG is a non-profit, non-partisan public interest advocacy group with members around the state.

Massachusetts Consumers Coalition

The Massachusetts Consumers' Coalition (MCC) was established in 1976 by representatives of local, state and federal consumer agencies, consumer advocacy organizations and others who were concerned with protecting consumers and ensuring fairness in the marketplace.

MASSPIRG

MASSPIRG represents 50,000 members across the state of Massachusetts in public interest matters including the environment, health care, public safety, consumer protection, clean water and safe food. Founded in 1972 is Massachusetts' largest environmental and consumer advocacy group. MASSPIRG's mission is to deliver persistent, result oriented public interest activism that protects the environment, improves health care, encourages a fair, sustainable economy, and fosters responsive, democratic government. In the watchdog tradition, MASSPIRG uncovers threats to public health and well being and fights to end them, using the

time-tested tools of investigative research, media exposés, grassroots organizing, advocacy, and litigation.

Media Access Project

Media Access Project is a twenty-four year old nonprofit, public interest law firm that represents the interests of the public to speak and to receive information via the electronic media of today and tomorrow

Mercer County Community Action

Mercer County Community Action is a 501(c)(3) non-profit established in May of 1966. Our mission is "Helping people. Changing Lives" We offer the following programs: Low Income Housing; Housing Counseling; weatherization; employment counseling and placement; consumer education and information; and utility assistance.

MontPIRG

The Montana Public Interest Research Group (MontPIRG) is a non-profit, non-partisan research and advocacy organization established and directed by Montana university students. It is funded by donations from students and other Montanans and does work pertaining to the environment, consumer protection and governmental responsibility.

National Alliance for Media Arts and Culture (NAMAC)

NAMAC is a nonprofit association composed of diverse member organizations who are dedicated to encouraging film, video, audio and online/multimedia arts, and to promoting the cultural contributions of individual media artists. NAMAC's regional and national members collectively provide a wide range of support services for independent media, including media education, production, exhibition, distribution, collection building, preservation, criticism and advocacy. NAMAC's member organizations include media arts centers, production facilities,

university-based programs, museums, film festivals, media distributors, film archives, multimedia developers, community access TV stations and individuals working in the field. Combined, the membership of these organizations totals around 400,000 artists and other media professionals.

New York Citizens Utility Board

The New York Citizens Utility Board represents residential ratepayers in New York State on matters related to public utilities.

NC PIRG

North Carolina Public Interest Research Group is a statewide non-profit, non-partisan consumer and environmental advocacy group, with 3,000 members in North Carolina. NCCC provides information, education, and advocacy for consumers in North Carolina.

North Carolina Justice and Community Development Center

The North Carolina Justice and Community Development Center is a non-profit, non-partisan organization founded and governed by low-income people, non-profit groups and legal community leaders. It pursues its mission of helping low income North Carolinians to escape poverty and achieve economic security through a four-pronged strategy of litigation, research, community education, and direct public policy advocacy.

OS PIRG (Oregon State)

OSPIRG is a statewide non-partisan, non-profit public interest research and advocacy organization with 33,000 members in Oregon.

Oregon Citizens Utility Board

The Citizens' Utility Board of Oregon is a statewide, non-profit organization designated in state law as the representative of residential ratepayers of regulated utilities. CUB was

founded by Oregon voters in 1984 and is supported by voluntary contributions from individual ratepayers.

Texas Consumer Association

The Texas Consumers Association is a nonprofit organization that has been representing small business and residential consumers in the state for over 30 years.

Texas Watch

Texas Watch is a bi-partisan; advocacy organization working to with Texas families and small businesses to ensure Texas public policy serves and meets their needs. Texas Watch works on a variety of issues affecting families, including consumer protection and insurance issues.

USPIRG

U.S. PIRG serves as the national association of and the national lobbying office for the State Public Interest Research Groups. State PIRGs are non-profit, non-partisan public interest advocacy groups. PIRGs have approximately one-half million members around the country.

United Church of Christ, Office of Communication, Inc. (UCC)

UCC is a non-profit corporation, charged by the Church's Executive Council to conduct a ministry in media advocacy to ensure that historically marginalized communities (women, people of color, low income groups, and linguistic minorities) have access to the public airwaves. The United Church of Christ has 1.4 million members and nearly 6,000 congregations. It has congregations in every state and in Puerto Rico.

Virginia Citizens Consumer Council

The Virginia Citizens Consumer Council is a grass roots consumer education and advocacy organization.

WashPIRG

WashPIRG. We are an environmental and consumer advocacy group. Our mission is to deliver persistent, result-oriented public interest activism that protects our environment, encourages a fair, sustainable economy, and foster responsive, democratic government.

Wisconsin Consumers League

The Wisconsin Consumers League is the oldest volunteer consumer protection organization in Wisconsin. The League has been advocating for consumer interests on a variety of topics before the Legislature, the regulatory agencies, and the general public since 1966.

II. PERSISTENT PROBLEMS OF ABUSIVE MARKET POWER IN THE CABLE INDUSTRY WILL BE EXACERBATED BY THE AT&T/COMCAST MERGER

A. CONCENTRATION IN THE CABLE INDUSTRY THROUGH MERGERS AND ACQUISITIONS HARMS CONSUMERS AND DOES NOT PROMOTE THE PUBLIC INTEREST

The attached studies demonstrate that the AT&T/Comcast merger is not in the public interest and should be rejected.[2] In order to reach that recommendation, the affidavit and analysis rely on a detailed economic analysis under the legal standards for merger review. However, there are simple and obvious facts about the cable market that consumers experience every day that lead to the same conclusion as a matter of common sense.

[2] "Statement of The Consumer Federation of America, Consumer Union, Center for Digital Democracy, and the Media Access Project on the AT&T-Comcast Merger," *Subcommittee on Antitrust, Business Rights, and Competition, Senate Judiciary Committee,* April 23, 2002 (hereafter Joint Statement); Mark Cooper, *The Failure of 'Intermodal' Competition in Cable Markets* (Consumer Federation of America and Consumers Union, April 2002) (Intermodalism Study); *New Media New Controls: AT&T Comcast's Hold on the Broadband Future*, April 2002 (hereafter, New Controls).

Since the passage of the Telecommunications Act of 1996, cable prices have increased by over forty percent, more than two-and-one-half times the rate of inflation.[3] Advertising and advanced service revenues have been growing even faster, and total revenue is up almost 60 percent.[4] Monopoly rents collected by cable companies in the form of inflated sale prices for their systems have doubled.[5]

The escalating price of cable services and market power of cable operators has been driven by mergers and acquisitions. Much to the consternation of the Federal Communications

[3] See Joint Statement, p. 3, U.S. Bureau of Labor Statistics, *Consumer Price Index.*

[4] Joint Statement, p. 4, based on Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fifth Annual Report, December 23, 1998, Appendix B, and Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B.

[5] See Id., for system prices, Joint Statement at 4. For an explanation and interpretation of monopoly rents embedded in these prices see "Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," in *Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002 (hereafter Horizontal Comments); and Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project, in Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, February 19, 2002 (hereafter, Horizontal Reply Comments).

Commission, its own analyses show that the larger the cable operators become and the more regional control they gain (by pulling cable systems into clusters), the higher are monthly prices[6] and the monopoly rents realized. Efficiency gains are not passed through to consumers in the form of lower prices. The process of expanding the size of the monopolist also increases their dominance of regional markets and expands their clout in national markets. Clustering and increasing the size of cable operators leads to higher prices, makes content discrimination easier and more profitable and increases barriers to entry.

As a result of past mergers, the cable industry remains one of the most persistent monopolies in the American economy.[7] The market power of the increasingly concentrated cable TV industry has been used to relentlessly raise prices and deny consumers choice over the two decades since the industry was deregulated. This merger would raise the level of concentration in the industry to unprecedented levels and reinforce that monopoly power.[8]

---

[6] "Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2002 (hereafter, Price Report 2002), p. 29. "Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2001 (hereafter, Price Report 2001), p. 31. "Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2000 (hereafter, Price Report 2000), p. 33.

[7] "Justice Department Sues to Block Primestar's Acquisition of News Corps/MCI's Direct Broadcast Satellite Assets," May 12, 1998, Department of Justice press release, refers to the "cable monopoly." In remarks made at the press conference, Assistant Attorney General Joel Klein added the adjective persistent.

[8] Intermodalism Study, p. 44.

B. PERVASIVE MARKET POWER PROBLEMS AFFLICT THE ATT/COMCAST MERGER

The ATT/Comcast merger poses a potent and complex problem of market power across several of the most important media and communications markets of the emerging information economy of 21st century. The problems involve their roles as sellers of programming and Internet services to the public and buyers of inputs from content producers.

ATT and Comcast are dominant distribution entities with market shares approaching monopoly levels in both the local multichannel video program distribution (MVPD) market and the high-speed Internet access services market.[9] As a result they possess monopoly (or market) power at the point-of-sale. In neither of these markets is there an effective alternative delivery mechanism (neither analog nor digital) that can discipline their market power. In both of these markets they have engaged in behaviors that frustrate entry.[10]

Both AT&T and Comcast are vertically integrated through ownership and joint ventures into the production of content (video programming and Internet service provision) for local distribution markets. They have exhibited repeated patterns of foreclosure, discrimination and other types of behaviors that increase barriers to entry and seek to preserve and enhance their market power in both of these markets. [11]

ATT/Comcast would also be one of the largest purchasers of content from both video and potentially Internet content producers. They exercise monopsony power as a buyer and have

---

[9] Intermodal Study, pp. 43, 46.

[10] Horizontal Comments, pp. 99-105, 127-129; Intermodal Study, pp. 25-31; "Comments Of The Consumer Federation Of America, Texas Office Of Public Utility Counsel, Consumers Union, And Center For Digital Democracy," *In the Matter of Review of the Section 251 Unbundling, Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Federal Communications Commission, CC Dockets Nos. . 01-338, 96-98, 98-147, April 5, 2002, pp. 49-73.

[11] Horizontal Comments, pp. 127-138; Horizontal Reply Comments, pp. 23-56.

repeatedly engaged in anticompetitive and discriminatory behaviors that leverage their monopsony power in these markets.[12]

Standing alone each of these problems would be enough to stop the merger or require remedies to prevent the accumulation of market power. Taken together they argue strongly against the merger.

C. Satellite Competition Does Not Constrain Cable Prices and Is Too Weak to Prevent the Abuse of Cable Market Power

Because cable operators continually buy each other out, strenuously avoiding head-to-head competition, public policy has come to rest on satellite as the primary source of meaningful competition for cable. Unfortunately, because of its cost and other characteristics, it has fallen far short of providing widespread and vigorous competition.[13] As noted, the FCC's own analysis shows that satellite does not exert significant competitive effect on cable industry price, quantity or quality.

Satellite garnered the bulk of its subscribers in areas not served by cable and before cable had a digital offering.[14] In this sense, it did not compete in the market with cable; it served markets that were adjacent to the cable market. Moreover, satellite sells a high-volume, high quality service niche product that does not compete for the business of the core customer base of cable.[15] In the past several years, since cable has been rolling out its digital offering, cable has been adding digital subscribers at a much higher rate than satellite and is now bundling high-speed Internet with digital service.[16] This is a bundle that cannot be matched by satellite.

---

[12] Horizontal Comments, pp. 127-138, Horizontal Reply Comments, pp. 33-56.
[13] Intermodalism Study, pp. 3-5.
[14] Intermodalism Study, pp. 7-13.
[15] Intermodalism Study, pp. 13-22.
[16] Intermodalism Study, p. 9.

In other words, having never been threatened by satellite for its core "lunch bucket" market, cable is now attacking satellite's niche with its digital service.

D. Cross-Technology Competition Has Failed Repeatedly To Discipline Cable Industry Market Power

This is not the first time that cross-technology competition has failed to discipline market power in the cable industry. In the 1984 Cable Act, the Congress gave the FCC the authority to deregulate prices in competitive cable TV markets. Congress had been told that competition between cable companies would grow as new cable operators overbuilt incumbents and competing technologies would add further competition. The FCC determined that three over-the-air channels were enough to establish effective competition with cable in each community. As a result, cable systems serving about 80 percent of the country were deregulated.

Effective competition failed to materialize either from the entry of additional cable companies into the local franchise area or from other technologies. Over-the-air signals were extremely feeble competition. Numerous examples of discrimination in programming came to light. Cable prices exploded and public outcry ensued. In an effort to stave off legislation to re-regulate cable, the FCC reconsidered its three over-the-air rule and switched to six over-the-air stations as a standard. However, the pricing abuse was too great and the FCC's standard too weak to convince Congress that cable's market power would be checked.

By 1992, Congress had observed a continuing monopoly at the point-of-sale, with increasing concentration at the national level and growing vertical integration between programming and distribution. Congress re-regulated cable rates in 1992 and placed a range of "procompetitive" conditions on the industry, including a requirement that the Commission develop a structural limit on ownership.

When Congress revisited the structure of the multichannel video market in the Telecommunications Act of 1996, it decided to relax rate regulation in anticipation of growing transmission competition from satellite and telephone companies. It cautiously left the ban on cross-ownership and the requirement for a horizontal limit in place.

Congressional caution was well grounded but the skepticism of competition for cable was probably inadequate. One of the great disappointments of the 1996 Telecommunications Act has been the failure of competition from alternative technologies to break down the market power of the incumbents.[17] Congress devoted a whole section of the law to telephone competition for cable through open video systems.[18] Open video systems are non-existent.[19] As the attached affidavit shows, cross-technology competition from satellite is weak as well. This track record teaches us that we should be skeptical of promises about future technologies that are "just around the corner," which will break the grip of the cable monopoly.

E. THE FAILURE OF HEAD-TO-HEAD COMPETITION IN THE CABLE INDUSTRY SHOULD NOT BE REWARDED; REJECTING MERGERS CAN STIMULATE COMPETITION

Often overlooked in the debate and review of mergers in Washington is the utter failure of the dominant cable companies to compete with one-another. It has been legal for quite some time for these companies to enter the service territories of the cable TV companies they are proposing to buy, or any other cable company in the nation. They could have obtained the requisite permits and built competing cable system to win customers. This kind of head-to-head

[17] Mark Cooper and Gene Kimmelman, *The Digital Divide Confronts the Telecommunications Act of 1996,* February 1999.

[18] Title II, part 5.

[19] Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fifth Annual Report, Appendix C.

competition would certainly be in the public interest. Through this competition, they could have grown as larger, or larger than the post-merger company would be.

They did not choose to do so. ***They never do.***

Ironically, in the twisted logic of the cable TV industry, which was born and raised behind the wall of monopoly franchise service territories, the fact that these companies have never tried to compete with one another,[20] even after they were allowed to, and have no plans to compete head-to-head,[21] is touted by them as a justification to allow them to become even larger. In other words, having been granted a monopoly area within which to build a market base and later disdained the opportunity to compete for customers outside their service territories, they claim they are to be rewarded for failing to compete by merging monopolies.

The claim that one big monopoly is no worse than two little monopolies is simply wrong. The process of expanding monopoly size through merger and acquisition harms the public in several ways. In addition to creating larger regional and national entities, as noted above, these mergers remove the most likely competitors, especially where systems are located in close proximity to each other. There is a simple principle that applies to the industry: 'if you let them, they will merge. If you do not let them, maybe they will compete.'

Cable companies clearly have a desire to become larger. If they were not allowed to do so through merger and acquisition, some of them might actually compete. At a minimum, consumers would enjoy the benefits of an extended period of competition, before one of the companies exited the market.

[20] Application, p. 66.
[21] Application, p. 66.

III. PROMISED CONSUMER BENEFITS OF PAST MERGERS HAVE EITHER FAILED TO MATERIALIZE OR DO NOT REQUIRE MERGERS TO BE ACHIEVED

When companies in the cable market, which is concentrated at the national and regional levels and a virtual monopoly at the point of sale, with its long history of the abuse of market power, decide to grow through acquisition, the anticompetitive and anti-consumer impacts of the mergers become obvious. In order to divert attention from these negative effects, the merging parties claim that consumers will be better off, even though actual or potential competition is diminished in the core market, and promise to compete in some other market or for some other product.

As with each of its previous mergers, AT&T claims that only through the merger can consumers enjoy the benefit of more facilities and competition in new markets that it will enter. Those benefits either never materialize or are paltry compared to the harm caused by the increased market power resulting from the merger.

A. LOCAL TELEPHONE COMPETITION IS NOT DEPENDENT ON THE MERGER AND ARE LIKELY TO BE SMALL

Three years ago, to support its purchase of MediaOne, AT&T insisted that only an integrated telephone/cable company could deliver competition in the telephone market. Now it is claiming that only by breaking up the company and selling its cable business to another cable company can cable company competition for local telephone service be furthered. The claim that unique expertise must be brought to bear in the local telephone market has been repeatedly rejected by the FCC in the process of approving mergers between regional bell operating

companies.[22] If the FCC believed that telephone expertise is a unique asset that must be brought to bear to enter the local telephony market, it could never have allowed the elimination of four of the largest local telephone companies. In fact, the FCC found that cable companies do not need to merger to deploy cable telephony, in the context of addressing the issue of ownership limits.[23] It would be utter hypocrisy to allow mergers in the telephone industry because telephone expertise is not critical and to allow mergers in the cable industry because it is.

The failure of other cable operators to offer telephone service reflects serious doubts about the economic viability of providing circuit switched telephony over cable facilities, not AT&T's superior telephony skills. AT&T's failure to negotiate telephone carriage agreements with other cable operators reflects their doubts about AT&T's approach to local telephone service and the closed, exclusionary approach that afflicts the industry. The viability of IP-telephony, for which other cable operators appear to be waiting, is certainly not dependent on this merger.

Finally, the large urban areas that are being acquired and clustered by this merger already enjoy the highest levels of competition. Thus, even if there were some reason to believe the

---

[22] "Reply comments of the Consumer Federation of America, Consumers Union and AARP, before the Federal communications Commission, before the Federal Communications Commission, *Proposed Transfer of Control SBC and Ameritech*, CC Docket" No. 98-141, November 16, 1998.

[23] 14 FCCRcd 19098 Par. 61

> A 30% limit allows a cable operator to gain access to a substantial portion of the market to provide Internet access and telephony. The cable operators have presented no credible evidence that a larger size is necessary for the deployment of advanced technologies or telephony. Moreover, we note the possibility of cooperative arrangements among operators to offer coordinated telephony services through their cable systems, so that a cable operator does not necessarily need to grow in absolute size beyond the limit in order to participate in the offering of a national telephony service.

merger would increase competition from cable telephony, the impact would take place in those markets that need it least.

B. Unique Efficiencies and Synergies Flowing From the Merger are Dubious and Efficiency Gains are Not Likely to Be Passed on to Consumers Because of a Lack of Competition

The uniquely complementary managerial skills that AT&T/Comcast claim to attribute to each other are dubious at best and certainly do not flow from a vertical union of the two. For example, if Comcast actually possessed unique regional programming, and were not leveraging its vertical market power by offering programming only to captive cable customers, it would certainly be offering to develop and sell programming on neighboring (and we are told non-competing) systems.

Claims that the merger is necessary to achieve an upgrade of AT&T's plant are dubious. Although most of the industry is upgrading its plant for digital video and high-speed Internet access service, AT&T claims it must merge to finish the upgrade, since only the huge size and combination with Comcast will allow it to get the job done. In fact, the cable operators in the rest of the industry, who are much smaller than AT&T, have done as well or better job than AT&T.[24] Perhaps what AT&T needs is new management, not bigger size?

The efficiencies and synergies that AT&T/Comcast claims will flow from its huge size and clout in the market will not be translated into consumer benefits, as they claim. The FCC's

---

[24] Compare Report on Industry Prices, p. 13 to Application, pp. 18-23:

System Capacity Percent of Systems Offering

	ATT	Industry Avg
Upgraded to 750 MHz	59	63
Digital programming	~76	78
Internet Access	61	71

own data shows that larger[25] and more regionally[26] powerful multiple system operators (MSOs) charge more.

C. Open Communications Networks Will Suffer a Setback as a Result of the Merger

When cable operators decided to enter the communications business by offering high-speed Internet access, they incurred the obligations to operate those systems in an open and nondiscriminatory manner. AT&T insisted that it would meet that obligation in a voluntary manner. AT&T's final broken promise is a commitment to Congress, the Federal Communications Commission and the American public that they would voluntarily provide non-discriminatory access to their broadband service offering. They broke that promise by dragging their feet for three years, in the meantime capturing the most lucrative customers under exclusive arrangements.[27] The terms and conditions that they now offer for access are completely antithetical to a true open communications system.[28]

The commercial access that AT&T and Comcast are offering involves the network owners

- choosing a small number of ISPs who can sell a restrictive set of services;
- telling the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;
- controlling the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and
- placing independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content.

---

[25] Price Report, 2002, p. 29.
[26] Price Report, 2001, p. 31; Price Report, 2000, p. 33.
[27] Intermodalism Study, pp 25-31.
[28] Intermodalism Study, pp. 36-38; UNE Comments, pp. 67-72.

Allowing the merger will exacerbate the problem because one large closed system is worse than two smaller closed systems.[29] By bringing an ever-larger segment of the market under the control of a single entity, steadfastly opposed to non-discriminatory access, the merger weakens the incentive to provide open access (a large enough market share insulates the dominant firm) for the system and forecloses a larger segment of the market to independent content providers. It allows a dominant firm to more easily dictate standards.[30]

D. AN OPEN SET TOP-BOX STANDARD WILL NOT BE ADVANCED BY THE MERGER

The damage that the merger would do to open communications networks will extend to the set-top box.[31] AT&T, along with other cable companies, promised the Commission and Congress that it would abide by the terms of the 1996 Telecommunications Act and allow the development of a competitive set-top box marketplace to move forward. AT&T and the other cable companies agreed to the timeline set out in the law, that by July 1, 2001 the market for set-top boxes would be open. It broke that promise—AT&T and the other cable operators have ensured that they will retain their lucrative customer equipment cash cow by keeping the Cable Labs standards process closed.[32]

AT&T uses its analog set-top box leasing scheme to subsidize its digital set-top boxes—evidenced by the fact that analog boxes cost the same as digital boxes when customers lease them monthly, but if a customer breaks their analog box, that customer must pay $200, whereas if they break a digital box the customer must pay AT&T $800. Therefore, it has a powerful interest to ensure that this market remains closed. By slow-rolling the technical standard and

[29] Intermodalism Study, pp. 8-10.
[30] Intermodalism Study, pp. 10-13; UNE Comments, pp. 33-46.
[31] New Controls, pp. 1-4..
[32] New Controls, pp. 4-5; Joint Statement, pp. 18-19.

forcing would-be set-top box competitors to sign an egregious licensing agreement whereby the company signing the agreement would have to virtually forfeit their intellectual property, the cable operators have killed any near term possibility of an open set-top market.

Microsoft's relationship to both AT&T and Comcast is a matter of significant concern as well. At the key moment in the bidding wars that AT&T engaged in for both MediaOne and Comcast conducted for AT&T, Microsoft was the deep pocket. In this transaction, in exchange for putting up cash, Microsoft gets preferential treatment. To fulfill their promise to the public and Congress for an open set top box market, AT&T offers a backroom deal cut with Microsoft that gives Microsoft preferential treatment for MSN Internet services and for operating software on set-top boxes. In reality, this is not an open market. Rather, it is a dramatic step moving set-top box architecture closer to closure.

The Commission simply cannot give any credence to the claims of public interest benefits.

IV. THE MERGER SHOULD BE REJECTED UNDER BOTH THE ANTITRUST LAWS AND THE COMMUNICATIONS ACT

A. THE MERGER VIOLATES THE DEPARTMENT OF JUSTICE MERGER GUIDELINES INTENDED TO PROTECT COMPETITION

If either of these companies had achieved the size and scope of the merged entity through competition, we would not be objecting. Indeed, we would not even have the opportunity to object, since the acquisition of market size and market power through superior efficiency and competition is not objectionable under the antitrust laws. It is only because these companies do not build new systems to compete, instead choosing to buy each other out; they come under the scrutiny of the antitrust laws.

The *Merger Guidelines* of the Department of Justice identify mergers that raise concern by measuring the impact of the merger on the level of concentration in specific markets.[33] The AT&T/Comcast merger increases the level of concentration in regional and national markets by five times the DOJ threshold.[34] It also facilitates the abuse of market power at the local level.

B. THE MERGER VIOLATES THE PUBLIC INTEREST STANDARDS OF THE COMMUNICATIONS ACT INTENDED TO PROTECT CONSUMERS AND PROMOTE DEMOCRATIC DISCOURSE

While this merger could be rejected under the standards of the antitrust laws alone, in the case of mergers involving media and communications companies, the competitive standards under the Sherman Act are actually not the front lines of scrutiny. Media and communications mergers are held to a higher standard under the Communications Act because they affect not only consumers in the commercial marketplace for information products, they also affect citizens in the marketplace of ideas.[35]

Under the public interest standard, the applicants must do more than show that the merger does not violate existing law: they must demonstrate that real, concrete benefits will accrue to the public, that the merger will not frustrate the Commission's ability to enforce the provisions of the Communications Act or its own regulations, and that the pro-competitive benefits of the merger will outweigh the loss of competition that results from any merger. Thus, even if it could be

---

[33] Intermodalism Study, p. 40.

[34] Intermodalism Study, p. 44.

[35] Horizontal Comments, pp. 203-225; "Comments Of Consumers Union, Consumer Federation Of America, Civil Rights Forum, Center For Digital Democracy, Leadership Conference On Civil Rights And Media Access Project," *In the Matter of Cross-Ownership of Broadcast Stations and Newspaper Newspaper/Radio Cross-Ownership Waiver Policy*, Federal Communications Commission , MM Docket No. . 01-235 96-197, December 3, 2001, pp. 7-21.

shown, under the antitrust laws, that the merge does not tend to reduce competition, or even if the FCC found it created a commercial gain, the FCC could find that the merger does not promote the public interest because it does harm to civic discourse.

In the case of the AT&T/Comcast merger, there is no such quandary. The merger clearly flunks both tests. The AT&T/Comcast merger violates the letter and the spirit of the Department of Justice merger guidelines in several markets and several aspects of the FCC rules governing the cable industry. In fact, in opposing the AT&T/MediaOne merger, it was pointed out that that merger broke the rules.[36] AT&T has never come into compliance with the rules, preferring to launch an attack on the rules. Ignoring or attempting to change the rules, as AT&T and Comcast have done, does not change the fundamental economic facts that gave rise to the rules in the first place.

In opposition to the AT&T MediaOne merger several of the Joint Commenters raised the concern that AT&T was twisting its ownership and management structure to claim a lack of ownership rights, which would run afoul of FCC rules. In other words**, AT&T wanted ownership without responsibility.**

> AT&T wants authorities to water down or abandon their definitions of influence over companies through ownership or through control of customers. Where the ownership is small AT&T wants the FCC to ignore it. Where it is large, AT&T wants the FCC to accept voluntary safeguards as a check on concentration of ownership.[37]

---

[36] Consumer Federation of America, et al, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services*, August 17, 1999 attached to "Petition to Dismiss or Deny of Consumers Union Consumer Federation of America and Media Access Project," *In the Matter of Applications for Consent to the Transfer of Licenses , MediaOne Group, Inc. Tranferor to AT&T Corp. Transferee,* Federal Communications Commission, Docket No. CS 99-251, August 23, 1999.

[37] "Petition to Dismiss or Deny of Consumers Union Consumer Federation of America and Media Access Project," *In the Matter of Applications for Consent to the Transfer of Licenses , MediaOne Group, Inc. Tranferor to AT&T Corp. Transferee,* Federal Communications Commission, Docket No. CS 99-251, August 23, 1999, p. 34.

The 'old' AT&T/TCI/MediaOne was a jumble of management gimmicks including tracking stocks a management committee for Time Warner cable systems, and an independent operating agreement for Cablevision. These arrangements do not eliminate the ability of the AT&T parent to influence the decisions of its corporate children and it is extremely difficult for regulators to police such arrangements to prevent abuses of influence. They deny regulators full oversight over major ownership decisions.

The proposed AT&T/Comcast merger takes this jumble of ownership mechanisms one step further, by adding a significant element of responsibility without ownership. AT&T retains substantial interests in each of the entities that were at issue in 1999, but now it will allow Comcast to run the company with a very small share of ownership. It will also insulate this non-owner management from the ultimate form of ownership discipline – getting fired – for an extremely long period of time. **AT&T/Comcast is predicated on responsibility without ownership.**

> The deal's Achilles' heel may be Comcast's plan to subjugate AT&T shareholder voting rights to management's effective control of the combined entity with only about 1% of the economic interest. Comcast wants to bundle approval of the AT&T Broadband merger with several anti-shareholder protection provisions; preventing removal of management for eight years, no combined board meeting until 2005, and limits of 10% stock ownership without board approval.[38]

The Enron debacle and numerous other examples of the mistreatment of stockholders by irresponsible management shed a very harsh light on these legal devices to divorce ownership from control and responsibility. The total abdication of responsibility in these deals can be underscored by the noting that AT&T prided itself on the fact that the board of one its subsidiaries never met. The new deal precludes the board from meeting for three years.

[38] Cleland.

It is time for the FCC and other federal agencies to demand that stock ownership be restored to its simple and direct meaning. The FCC should reject these manipulated stock gimmicks.[39] That would stop the merger in its tracks. It would require substantial divestiture of stocks and a complete restructuring of the deal.

C. THE PUBLIC UNDERSTANDS THE DANGER OF MERGERS IN THE MASS MEDIA AND COMMUNICATIONS INDUSTRIES

The attached study demonstrates in detail that the merging parties have failed to show that the likely benefits of the merger exceed its harms. To the contrary, there are virtually no demonstrable and verifiable public interest benefits that could not be achieved if there were no merger and substantial public interest harms because of the merger.

The study, as well as much of the regulatory analysis is framed in the complex terms of economic analysis that is grounded in theory and empirical research. The conclusion is clear; increasingly concentrated media and communications markets created by these mergers poorly serve the public. The public bears the brunt of this market failure in the form of rising prices and poor service. The broad array of public interest and consumer groups that support this petition attests to the problems that consumers suffer at the hands of the cable industry. Public opinion toward mergers is shaped by that real world experience of consumers.

In response to survey questions the public expresses strong concerns about increasing size and concentration in the media and communications industries.[40] With respect to the AT&T/Comcast merger, two thirds of the respondents to one recent survey said that the AT&T/Comcast merger should be denied.[41] The most frequent problem volunteered by

[39] Joint Statement, pp. 21-23.
[40] Joint Statement, pp. 23-25.
[41] *Cable/Satellite Television Survey* (Lauer Research Inc, March 2002).

respondents with communications industry mergers was the lack of choice and competition (34 percent). The second most frequent problem was higher prices. The sheer size of the companies was a distant third (9 percent).

The public has taken this dim view of communications industry mergers for some time. In late 1995, just prior to the passage of the Telecommunications Act, the Consumer Federation of America and the Center for Digital Democracy commissioned a national public opinion poll on this subject.[42] Without a specific merger in mind, 54 percent felt public policy should make it harder for cable mergers to take place. Half the respondents felt the mergers would lead to higher prices compared to only one-eight who felt prices would go down. By more than a two-to-one margin, respondents believe that quality will become worse, not better (36% v. 14%).

D. CONCLUSION

Under any reasonable interpretation of either the Communications Act or the antitrust laws, this merger should be rejected. The failure of the DOJ and the FCC to enforce their rules has resulted in substantial harm to consumers. This merger would make matters much worse, creating a huge national entity with consolidated control over important regional markets. Federal authorities have let consumers down.

There is a simple principle that applies to the industry: 'if you let them, they will merge. If you do not let them, maybe they will compete.' These companies clearly have a mandate for growth. If they were not allowed to do so through merger and acquisition, they would have to grow through competition. The merging parties have failed to show that the likely benefits of the merger exceed it harms. To the contrary, there are virtually no demonstrable and verifiable

public interest benefits that could not be achieved if there were no merger and substantial public interest harms of the merger.

The fact that the last, bad merger was approved on the basis of the same false promises should not be justification for approval of the next bad merger. To the contrary, it is about time that the Commission learned the obvious lesson. The highly concentrated cable industry possesses market power and these mergers are making it worse. Enough is enough. This merger must be denied.

WHEREFORE,

because Applicants have not met their burden under Sections 214 and 310 of the Communications Act of 1934 and have not proved that grant of the Application would serve the public interest -- and in fact, as Petitioners demonstrate, grant of the Application would harm the public interest -- the Commission must deny the Application or designate the Application for hearing.

---

[42] *Mergers and Deregulation on the Information Superhighway: The Public Takes a Dim View* (Consumer Federation of America and Center for Media Education [now the Center for Digital Democracy: September 1995).

DECLARATION

Dr. Mark Cooper declares as follows:

1. I am Director of Research at Consumer Federation of America.

2. This declaration is submitted in support of the *Petition to Deny* the *Applications for Consent to the Transfer of Control of Licenses of Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, Docket No. MB 02-70, filed on behalf of Arizona Consumer Council, *et al.*

3. I have reviewed the factual assertions contained in the *Petition to Deny* and I declare that they are true to the best of my knowledge.

I hereby state under penalty of perjury the forgoing is correct and true.

Executed on April 29, 2002

Dr. Mark Cooper

STATEMENT OF

THE CONSUMER FEDERATION OF AMERICA,
CONSUMERS UNION,
CENTER FOR DIGITAL DEMOCRACY,
AND
THE MEDIA ACCESS PROJECT

ON THE AT&T-COMCAST MERGER

Submitted to the

SUBCOMMITTEE ON ANTITRUST, BUSINESS RIGHTS AND COMPETITION
SENATE JUDICIARY COMMITTEE

April 23, 2002

Mr. Chairman and Members of the Committee,

For policymakers and advocates who believe that competition is the consumer's best friend, the cable industry presents an ugly, anti-competitive picture where the consumer truly has no friends. In the late 1990s, the Attorney General called the cable industry "the most pernicious monopoly in the American economy." Things have only gotten worse. The cable industry continues to posses and abuse market power in video markets and is extending it into advanced telecommunications markets. Claims that competition from alternative technologies is sufficient to discipline cable in either the video distribution or high-speed Internet access market are not supported by the empirical evidence. This merger will take a highly concentrated industry to unprecedented—previously unthinkable—levels of concentration and will make life worse for consumers who are captive to cable monopolists.

I. THE ENDURING CABLE MONOPOLY

A. THE ANTI-COMPETITIVE HISTORY OF THE INDUSTRY

In its current form, the industry was born with franchise monopoly service territories in the 1970s. The Cable Act of 1984 deregulated rates and restricted the ability of local franchise authorities to oversee the industry. Congress gave the FCC the authority to deregulate prices in competitive cable TV markets. Congress had been told that competition between cable companies would grow as new cable operators overbuilt incumbents and competing technologies would add further competition. The FCC determined that three over-the-air channels were enough to establish effective competition with cable in each

community. As a result, cable systems serving about 80 percent of the country were deregulated.

Effective competition failed to materialize either from the entry of additional cable companies into the local franchise area or from other technologies. Over-the-air signals were extremely feeble competition. Numerous examples of discrimination in programming came to light. Cable prices exploded and public outcry ensued. In an effort to stave off legislation to re-regulate cable, the FCC reconsidered its three over-the-air rule and switched to six over-the-air stations as a standard. However, the pricing abuse was too great and the FCC's standard too weak to convince Congress that cable's market power would be checked.

By 1992, Congress had observed a continuing monopoly at the point-of-sale, with increasing concentration at the national level and growing vertical integration between programming and distribution. Congress re-regulated cable rates in 1992 and placed a range of "procompetitive" conditions on the industry, including a requirement that the Commission develop a structural limit on ownership.

When Congress revisited the structure of the multichannel video market in the Telecommunications Act of 1996, it decided to relax rate regulation in anticipation of growing transmission competition from satellite and telephone companies. It cautiously left the ban on cross-ownership and the requirement for a horizontal limit in place.

B. THE FAILURE OF CABLE COMPETITION SINCE THE TELECOMMUNICATIONS ACT OF 1996

When Congress decided to move media and communications policy toward greater reliance on competition in the Telecommunications Act of 1996, the cable operators again headed in the opposite direction. Rather than use their expertise, existing plant and ownership

of programming to enter neighboring service territories, the dominant cable companies chose to buy each other instead. The monopolies they had gained through franchise awards and defended through anticompetitive behavior were merged into ever-larger groups. The result has been a dramatic increase in concentration and clustering of systems.

While eschewing competition in their core market, they moved into the communications and Internet service markets, bringing along their anticompetitive business model that relies on closed and restricted access to the consumer. Through contracts and court cases they have fought a five-year battle to keep their advanced telecommunications networks closed and operate them on a proprietary basis.

Congressional caution in the 1996 Act was well grounded but its excessive optimism in the development of competition for cable was totally inappropriate. One of the great disappointments of the 1996 Telecommunications Act has been the failure of competition from alternative technologies to break down the market power of the incumbents.[43] Congress devoted a whole section of the law to telephone competition for cable through open video systems.[44] Open video systems are non-existent.[45] As the attached study shows, cross-technology competition from satellite is weak as well. This track record teaches us that we should be very skeptical of promises about future technologies that are "just around the corner," which will break the grip of the cable monopoly.

The market power of the cable operators is most apparent to the consumer in the pattern of pricing and monopoly profits since the passage of the Telecommunications Act of

[43] Mark Cooper and Gene Kimmelman, The Digital Divide Confronts the Telecommunications Act of 1996, February 1999.

[44] Title II, part 5.

1996 (see Exhibit 1). Since 1996, cable prices have increased by over forty percent, more than two-and-one-half times the rate of inflation.[46] Basic service prices have increased even more rapidly. Advertising and advanced service revenues have been growing even faster, and total revenue is up almost 60 percent.[47] On a per subscriber basis, monthly revenues are up over 50 percent.

In the longer term, the ability to raise prices as several times the rate of inflation is evident (see Exhibit 2). With the exception of the short period of regulation in 1992-1996, cable prices have been largely unregulated. Whenever they are, they increase at about 2.5 times the rate of overall inflation.

This market power to set prices results in the collection of monopoly rents. One frequent measure of monopoly power is the ability of owners to sell their asset for more than it would cost a competitor to build them, if competitors could enter the market (a measure called Tobin's q). Monopoly rents are paid because barriers to entry allow incumbents to sell assets above their competitive market value. Sales prices for cable systems have increased sharply, whenever prices are deregulated. Since the passage of the 1996 sales prices of systems have more than doubled[48] and monopoly rents collected by cable companies have

---

[45] Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Fifth Annual Report, Appendix C.

[46] U.S. Bureau of Labor Statistics, *Consumer Price Index.*

[47] Contrast Federal Communications Commission, *In the Matter of Annual Assessment of Competition In Markets for the Delivery of Video Programming*, Fifth Annual Report, December 23, 1998, Appendix B, and Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B.

[48] See Id., for system prices. For an explanation and interpretation of monopoly rents embedded in these prices see "Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and

increased accordingly (see Exhibit 3).[49] The measure of market power tracks real price increases closely, which is precisely what economic theory predicts.

C. THE FAILURE OF HEAD-TO-HEAD COMPETITION IN THE CABLE INDUSTRY SHOULD NOT BE REWARDED

Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," in *Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; and Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project, in Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, February 19, 2002,

[49] Market power is frequently measured by the Lerner Index, which is the mark-up of price above costs (see F. M. Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990), pp-21-22 ; Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981, p. 947. Tobin's q is a direct measure of monopoly rents (which is the ratio of asset value to reproductions costs (Scherer and Ross, at 415... 416). Therefore, we would expect price and Tobin's q to parallel one another, holding costs constant. The increase in HHI can be directly related the Lerner Index by dividing by the elasticity of demand ((W. Kip Viscusi, John M. Vernon, Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* (Cambridge, MIT Press: 2000), p. 149). Most recently the elasticity of demand has been estimated by the FCC at 2.19 ("Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2002 (hereafter, Price Report 2002), p. 29), which would suggests increasing monopoly rents consistent with the price and Tobin's q numbers.

Often overlooked in the debate and review of mergers in Washington DC is the utter refusal of the dominant cable companies to compete with one-another. It has been legal for quite some time for these companies to enter the service territories of the cable TV companies they are proposing to buy, or any other cable company in the nation. They could have obtained the requisite permits and built competing cable system to win customers. This kind of head-to-head competition would certainly be in the public interest. Through this competition, they could have grown as larger, or larger than the proposed post-merger company would be.

They did not choose to do so. ***They never do.***

Ironically, in the twisted logic of the cable TV industry, which was born and raised behind the wall of monopoly franchise service territories, the fact that these companies have never tried to compete with one another,[50] even after they were allowed to, and have no plans to compete head-to-head,[51] is touted by them as a justification to allow them to become even larger. In other words, having been granted a monopoly area within which to build a market base and later disdained the opportunity to compete for customers outside their service territories, they claim they are to be rewarded for failing to compete by merging monopolies.

D. SATELLITE COMPETITION DOES NOT CONSTRAIN CABLE PRICES AND IS TOO WEAK TO PREVENT THE ABUSE OF CABLE MARKET POWER

Because cable operators continually buy each other, strenuously avoiding head-to-head competition, public policy has come to rest on satellite as the primary source of

[50] "Application and Public Interest Statement," *In the Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (hereafter, Application), p. 66.

meaningful competition for cable. Unfortunately, because of its cost and other characteristics, it has fallen far short of providing widespread and vigorous competition. The FCC's own analysis shows and has consistently shown that satellite does not now, nor has it ever, exerted a significant and substantial competitive effect on cable industry price, quantity or quality.

Satellite garnered the bulk of its subscribers in areas not served by cable and before cable had a digital offering (see Exhibit 4). In this sense, it did not compete in the market with cable; it served markets that were adjacent to the cable market. Moreover, satellite sells a high-volume, high quality service niche product that does not compete for the business of the core customer base of cable. In the past several years, since cable has been rolling out its digital offering, cable has been adding digital subscribers at a much higher rate than satellite and is now bundling high-speed Internet with digital service (see Exhibit 5). This is a bundle that satellite cannot match.

In other words, having never been threatened by satellite for its core "lunch bucket" market, cable is now attacking satellite's niche with its digital service. The attached study and analysis demonstrates that the weak and narrow competitive overlap between satellite and cable is likely to become weaker and narrower in the foreseeable future.

II. CABLE MARKET POWER OVER A CRITICAL DIGITAL COMMUNICATIONS PLATFORM

A. DIGITAL CABLE IS A MULTI-PURPOSE COMMUNICATIONS PLATFORM

[51] Application, p. 66.

In order to grasp the strength and spread of the pernicious market power of the cable industry it is useful to think of a communications platform that provides an environment in which information or content is produced (see Exhibit 6). Three layers – the physical layer, the logic or code layer, and the content layer – define the communications platform.[52] It is a platform because there are strong complementarities between the layers.[53] They must fit together closely and smoothly in order to deliver service.

The physical layer is composed of two parts: a transmission medium (e. g.. wires) and the appliances or devices that receive signals.

The logic (or code) layer involves the codes and standards with which appliances interconnect, interoperate, and communicate. Protocols interpret the signals. Operating systems allocate and coordinate the resources of the system. The operating systems and communications protocols can be resident in either the appliances and devices or network

---

[52] Yochai Benkler, "From Consumers to Users: Shifting the Deeper Structure of Regulation Toward Sustainable Commons and User Access," *Federal Communications Law Journal*, 56 (2000) (hereafter Consumers to Users), "Intellectual Property and the Organization of Information Production," forthcoming in *International Journal of Law and Economics*, (hereafter, Intellectual Property); "Coase's Penguin, or Linux and the Nature of the Firm," *Conference on the Public Domain"* Duke University Law School, (November 9-11, 2001) (hereafter, Coase's Penguin); "The Battle Over the Institutional Ecosystem in the Digital Environment," *Communications of the ACM*, 44:2 (February, 2001); Lawrence Lessig, *The Future of Ideas* (New York: Random House, 2001), p. 23. Lessig notes that Tim Berners-Lee (*Weaving the Web: The Original Design and Ultimate Destiny of the World Wide Web by Its Inventor* (San Francisco: Harper San Francisco, 1999), identifies four layers, transmission, computer, software and content.

[53] Carl Shapiro and Hal R. Varian, *Information* R*ule*s (Cambridge: Harvard Business School Press, 1999), pp. 9 – 15; Richard N. Langlois, "Technology Standards, Innovation, and Essential Facilities: Toward a Schumpeterian Post-Chicago Approach," in Jerry Ellig (Ed.), *Dynamic Competition and Public Policy: Technology, Innovations, and Antitrust Issues* (Cambridge: Cambridge University Press, 2001), p. 207, calls them system products – "Most cumulative technologies are in the nature of systems products, that is products that permit or require simultaneous functioning of a number of complementary components." Complementarities exist where standards knit the layers of the platform together.

equipments (e.g. routers and switches in the information space, the head end or CMTS in the video space).

The content layer is composed of applications and information products, such as television programs, music, e-mail, instant messaging or Web sites.

B. Pervasive Market Power Problems In the Cable Industry

In the contemporary cable industry, the transmission medium is primarily hybrid fiber coaxial cable that provides the last-mile connection to the residence (See Exhibit 7). Fiber optic cables are found in the backbone of the network.

The display device for video is the TV and the appliance for connecting the device to the network is the set top box. The PC is the typical display device for Internet service and the appliance for connecting the device to the network is the modem.

At each layer of the system, cable operators exert market power. In the physical layer, they control approximately 85 percent of the customers in the video market and 65 to 75 percent of the high-speed Internet market.

At the logical (or code) layer, they use proprietary standards and protocols (ITV operating systems and DOCSIS) or can control the settings of protocols to determine which traffic can flow. Policy based routing is an approach to the management of traffic flows that allows the network owner to favor its own content or foreclose specific content from specific providers. A particular bone of contention has been restrictions on the functionalities that are made available to competing suppliers of content (restrictions on streaming video or stripping of bits) and consumers (restrictions on upstream transmission).

Cable operators own a great deal of the most popular video content, which they favor with beneficial terms of carriage and exclusive dealing arrangements. They launched their high speed Internet services under exclusive deals with a single provider in which the dominant firms held an operating interest. The dispute with non-affiliated service providers has extended to the customer relationship.

As bleak as this picture is, the merger would make matters much worse. This merger would raise the level of concentration in the industry to unprecedented levels and reinforce that monopoly power. The ATT/Comcast merger poses a potent and complex problem of market power across several of the most important media and communications markets of the emerging information economy of 21st century. The problems involve their roles as sellers of programming and Internet services to the public and buyers of inputs from content producers.

ATT and Comcast are dominant distribution entities with market shares approaching monopoly levels in both the local multichannel video program distribution (MVPD) market and the high-speed Internet access services market. As a result they possess monopoly (or market) power at the point-of-sale. In neither of these markets is there an effective alternative delivery mechanism (neither analog nor digital) that can discipline their market power. In both of these markets they have engaged in behaviors that frustrate entry.

Both AT&T and Comcast are vertically integrated through ownership and joint ventures into the production of content (video programming and Internet service provision) for local distribution markets. They have exhibited repeated patterns of foreclosure, discrimination and other types of behaviors that increase barriers to entry and seek to preserve and enhance their market power in both of these markets.

ATT/Comcast would also be one of the largest purchasers of content from both video and potentially Internet content producers. They exercise monopsony power as a buyer and have repeatedly engaged in anticompetitive and discriminatory behaviors that leverage their monopsony power in these markets.

Standing alone, each of these problems would be enough to stop the merger or require remedies to prevent the accumulation of market power. Taken together, they argue irrefutably that this merger must not be permitted.

C. THE IMPACT OF THE MERGER ON THE VIDEO MARKET

The claim that one big monopoly is no worse than two little monopolies is simply wrong. The process of expanding monopoly size through merger and acquisition harms the public in several ways (see Exhibit 8). In addition to creating larger regional and national entities, as noted above, these mergers remove the most likely competitors, especially where systems are located in close proximity to each other.

We start at the root of the market power. Although the cable companies have made a great deal of the fact that they do not compete against one another, the mergers and consolidation in the industry do have an impact.

Economic theory and empirical evidence recognize size can create a barrier to entry, requiring new entrants to mount larger efforts to get into markets. This is particularly true where cable operators are located within one geographic area. As they cluster their systems, they gain additional leverage of the local market (area-wide advertising, marquee programming, etc.). Regional clustering may also make it easier to distribute certain regional

programming (like local sports) terrestrially (rather than by satellite). This enables vertically integrated cable owners to withhold the programming from competing distributors.

The size of the cable owner plays an important role in the content layer. Large operators gain leverage in bargaining with content providers.

Much to the consternation of the Federal Communications Commission, its own analyses show that the larger the cable operators become and the more regional control they gain (by pulling cable systems into clusters), the higher are monthly prices[54] and the monopoly rents realized. Efficiency gains are not passed through to consumers in the form of lower prices. Clustering and increasing the size of cable operators leads to higher prices, makes content discrimination easier and more profitable and increases barriers to entry.

D. Open Communications Networks Will Suffer a Setback as a Result of the Merger

The broadband Internet access market is dominated by a very small number of facility owners who have market power and incentive to discriminate against independent content providers (see Exhibit 9). Almost half of the zip codes in the nation have less than two high-speed Internet service providers. Virtually all other markets are tight oligopolies, or duopolies.

[54]Price Report, 2002, p. 29. "Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2001 (hereafter, Price Report 2001), p. 31. "Report on Cable Industry Prices," *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, February 14, 2000 (hereafter, Price Report 2000), p. 33

Busienss and residential markets are segmented and concentration is higher within each segment. Cable dominates the residential high-speed Internet market, with a 65 percent market share for all "broadband" services. However, it has a 75 percent market share for the advanced services residential market. Digital Subscriber Line service (DSL), the telephone industry's high-speed offering, dominates the non-residential market with an 89 percent market share.

Using its market power in the high-speed Internet access market, cable has priced its service strategically, charging a low price for digital video tiers of service and a high price for cable modem service. Although the digital tier and cable modem service are provisioned from the same technology upgrade and have similar incremental costs, cable operators have priced cable modem service at three to four times the level of the digital video tier. Cable also forces virtually all consumers to give up their current Internet Service Provider to get cable modem service, or to pay an additional fee to keep that provider.

When cable operators decided to enter the communications business by offering high-speed Internet access, they incurred the obligations to operate those systems in an open and nondiscriminatory manner. AT&T insisted that it would meet that obligation in a voluntary manner. AT&T's final broken promise is a commitment to Congress, the Federal Communications Commission and the American public that they would voluntarily provide non-discriminatory access to their broadband service offering. They broke that promise by dragging their feet for three years, in the meantime capturing the most lucrative customers under exclusive arrangements. The terms and conditions that they now offer for access are completely antithetical to a true open communications system.

The commercial access that AT&T and Comcast are offering is nowhere near what is needed to preserve the competitive, consumer-friendly, innovation rich environment we have come to know and love on the Internet. The cable owner

- chooses a small number of ISPs who can sell a restrictive set of services;
- tells the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;
- controls the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and
- places independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content.

Cable operators have a strong incentive to retard innovation that might compete directly with their core video services, or even indirectly for consumer video entertainment attention. Restricting the number of service providers and the services they can provide ensures cable companies control the flow of innovations and takes away the incentive to develop new applications. This is the antithesis of how the Internet was created. In the narrowband Internet, intramodal competition at the level of content – ensuring that content providers and applications developers were given non-discriminatory access to facilities – was highly successful in stimulating entry and innovation.

The cable operators' closed networks are apparent in the statistics of high-speed Internet access providers (see Exhibit 10). There are only 47 high-speed Internet service providers using cable modem service nationwide – essential the monopoly cable companies offering service on an exclusive basis in their franchise areas. This number has been virtually constant for past two years. There are almost three times as many high-speed Internet access

service providers using other technologies, and this number has almost doubled in the past two years.

Allowing the merger will exacerbate the problem because one large closed system is worse than two smaller closed systems. By bringing an ever-larger segment of the market under the control of a single entity, steadfastly opposed to non-discriminatory access, the merger weakens the incentive to provide open access (a large enough market share insulates the dominant firm) for the system and forecloses a larger segment of the market to independent content providers. It allows a dominant firm to more easily dictate standards.

III. PROMISED CONSUMER BENEFITS OF PAST MERGERS HAVE EITHER FAILED TO MATERIALIZE OR DO NOT REQUIRE MERGERS TO BE ACHIEVED

When companies in the cable market, which is concentrated at the national and regional levels and a virtual monopoly at the point of sale, with its long history of the abuse of market power, decide to grow through acquisition, the anticompetitive and anti-consumer impacts of the mergers become obvious. In order to divert attention from these negative effects, the merging parties falsely claim that consumers will be better off, even though actual or potential competition is diminished in the core market, and promise to compete in some other market or for some other product.

As with each of its previous mergers, AT&T claims that only through the merger can consumers enjoy the benefit of more facilities and competition in new markets that it will enter. Those benefits either never materialize or are paltry compared to the harm caused by the increased market power resulting from the merger.

A. LOCAL TELEPHONE COMPETITION IS NOT DEPENDENT ON THE MERGER AND ARE LIKELY TO BE SMALL

Three years ago, to support its purchase of MediaOne, AT&T insisted that only an integrated telephone/cable company could deliver competition in the telephone market. Now it is claiming that only by breaking up the company and selling its cable business to another cable company can cable company competition for local telephone service be furthered. In the process of approving mergers between regional bell operating companies, the FCC has repeatedly rejected the claim that unique expertise must be brought to bear in the local telephone market.[55] If the FCC believed that telephone expertise is a unique asset that must be brought to bear to enter the local telephony market, it could never have allowed the elimination of four of the largest local telephone companies. It would be utter hypocrisy to allow mergers in the telephone industry because telephone expertise is not critical and to allow mergers in the cable industry because it is.

The failure of other cable operators to offer telephone service reflects serious doubts about the economic viability of providing circuit switched telephony over cable facilities, not AT&T's superior telephony skills. AT&T's failure to negotiate telephone carriage agreements with other cable operators reflects their doubts about AT&T's approach to local telephone service and the closed, exclusionary approach that afflicts the industry. The viability of IP-telephony, for which other cable operators appear to be waiting, is certainly not dependent on this merger.

---

[55] "Reply comments of the Consumer Federation of America, Consumers Union and AARP, before the Federal communications Commission, before the Federal Communications Commission, *Proposed Transfer of Control SBC and Ameritech*, CC Docket" No. 98-141, November 16, 1998.

Finally, the large urban areas that are being acquired and clustered by this merger already enjoy the highest levels of competition. Thus, even if there were some reason to believe the merger would increase competition from cable telephony, the impact would take place in those markets that need it least.

B. Unique Efficiencies and Synergies Flowing From the Merger are Dubious and Efficiency Gains are Not Likely to Be Passed on to Consumers Because of a Lack of Competition

The uniquely complementary managerial skills that AT&T/Comcast claim to attribute to each other are dubious at best and certainly do not flow from a vertical union of the two. For example, if Comcast actually possessed unique regional programming, and were not leveraging its vertical market power by offering programming only to captive cable customers, it would certainly be offering to develop and sell programming on neighboring (and we are told non-competing) systems.

Claims that the merger is necessary to achieve an upgrade of AT&T's plant are dubious. Although most of the industry is upgrading its plant for digital video and high-speed Internet access service, AT&T claims it must merge to finish the upgrade, since only the huge size and combination with Comcast will allow it to get the job done. In fact, the cable operators in the rest of the industry, who are much smaller than AT&T, have done as well or better job than AT&T.[56] Perhaps what AT&T needs is new management, not bigger size.

---

[56] Compare Report on Industry Prices, p. 13 to Application, pp. 18-23:

System Capacity Percent of Systems Offering

	ATT	Industry Avg
Upgraded to 750 MHz	59	63
Digital programming ~76		78
Internet Access	61	71

The efficiencies and synergies that AT&T/Comcast claims will flow from its huge size and clout in the market will not be translated into consumer benefits, as they claim. The FCC's own data shows that larger[57] and more regionally[58] powerful multiple system operators (MSOs) charge more.

C. AN OPEN SET TOP-BOX STANDARD WILL NOT BE ADVANCED BY THE MERGER

AT&T, along with other cable companies, promised the Commission and Congress that it would abide by the terms of the 1996 Telecommunications Act and allow the development of a competitive set-top box marketplace to move forward. AT&T and the other cable companies agreed to the timeline set out in the law, that by July 1, 2001 the market for set-top boxes would be open. It broke that promise—AT&T and the other cable operators have ensured that they will retain their lucrative customer equipment cash cow by keeping the Cable Labs standards process closed. AT&T uses its analog set-top box leasing scheme to subsidize its digital set-top boxes—evidenced by the fact that analog boxes cost the same as digital boxes when customers lease them monthly, but if a customer breaks their analog box, that customer must pay $200, whereas if they break a digital box the customer must pay AT&T $800. Therefore, it has a powerful interest to ensure that this market remains closed. By slow-rolling the technical standard and forcing would-be set-top box competitors to sign an egregious licensing agreement whereby the company signing the agreement would have to virtually forfeit their intellectual property, the cable operators have killed any near term possibility of an open set-top market.

[57] Price Report, 2002, p. 29.
[58] Price Report, 2001, p. 31; Price Report, 2000, p. 33.

Microsoft's relationship to both AT&T and Comcast is a matter of significant concern as well. At the key moment in the bidding wars that AT&T engaged in for both MediaOne and Comcast conducted for AT&T, Microsoft was the deep pocket. In this transaction, in exchange for putting up cash, Microsoft gets preferential treatment. To fulfill their promise to the public and Congress for an open set top box market, AT&T offers a backroom deal cut with Microsoft that gives Microsoft preferential treatment for MSN Internet services and for operating software on set-top boxes. In reality, this is not an open market. Rather, it is a dramatic step moving set-top box architecture closer to closure.

IV. THE MERGER SHOULD BE REJECTED UNDER BOTH THE ANTITRUST LAWS AND THE COMMUNICATIONS ACT

A. THE MERGER VIOLATES REASONABLE COMPETITIVE AND PUBLIC INTEREST STANDARDS

If either of these companies had achieved the size and scope of the merged entity through competition, we would not be objecting. Indeed, we would not even have the opportunity to object, since the acquisition of market size and market power through superior efficiency and competition is not objectionable under the antitrust laws. It is only because these companies do not build new systems to compete, but instead choose to buy each other out that they come under the scrutiny of the antitrust laws.

The *Merger Guidelines* of the Department of Justice identify mergers that raise concern by measuring the impact of the merger on the level of concentration in specific markets. The AT&T/Comcast merger increases the level of concentration in national markets by five times the DOJ threshold (See Exhibit 11). As discussed above, it also facilitates the abuse of market power at the regional and local levels.

While this merger could be rejected under the standards of the antitrust laws alone, in the case of mergers involving media and communications companies, the competitive standards under the Sherman Act are actually not the front lines of scrutiny. Media and communications mergers are held to a higher standard under the Communications Act because they affect not only consumers in the commercial marketplace for information products, they also affect citizens in the marketplace of ideas.

Under the public interest standard, the applicants must do more than show that the merger does not violate existing law: they must demonstrate that real, concrete benefits will accrue to the public, that the merger will not frustrate the Commission's ability to enforce the provisions of the Communications Act or its own regulations, and that the pro-competitive benefits of the merger will outweigh the loss of competition that results from any merger. Thus, even if it could be shown, under the antitrust laws, that there is a net commercial consumer gain from the merger, the Federal Communications Commission could find that the merger does not promote the public interest because it does harm to civic discourse.

In the case of the AT&T/Comcast merger, there is no such quandary. The merger clearly flunks both tests. The AT&T/Comcast merger violates the letter and the spirit of the Department of Justice merger guidelines in several markets and several aspects of the FCC rules governing the cable industry.

B. THE FCC SHOULD ENFORCE ITS RULES AND STOP ENCOURAGING COMPANIES TO PLAY GAMES TO EVADE THEM

In opposing the AT&T/MediaOne merger, we pointed out that that merger broke the rules.[59] AT&T has never come into compliance with the rules, preferring to launch an attack on the rules. Ignoring or attempting to change the rules, as AT&T and Comcast have done, does not change the fundamental economic facts that gave rise to the rules in the first place. In the post-Enron era, the FCC must stop treating the ownership question so lightly.

In our opposition to the AT&T MediaOne merger we raised the concern that AT&T was twisting its ownership and management structure to claim a lack of ownership rights, which would run afoul of FCC rules. In other words**, AT&T wanted ownership without responsibility.**

> AT&T wants authorities to water down or abandon their definitions of influence over companies through ownership or through control of customers. Where the ownership is small AT&T wants the FCC to ignore it. Where it is large, AT&T wants the FCC to accept voluntary safeguards as a check on concentration of ownership.[60]

The 'old' AT&T/TCI/MediaOne was a jumble of management gimmicks including tracking stocks a management committee for Time Warner cable systems, and an independent operating agreement for Cablevision. These arrangements do not eliminate the ability of the AT&T parent to influence the decisions of its corporate children and it is extremely difficult for regulators to police such arrangements to prevent abuses of influence. They deny regulators full oversight over major ownership decisions.

---

[59] Consumer Federation of America, et al, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services*, August 17, 1999.

[60] Petition to Deny, p. 34.

The proposed AT&T/Comcast merger takes this jumble of ownership mechanisms one step further, by adding a significant element of responsibility without ownership. AT&T retains substantial interests in each of the entities that were at issue in 1999, but now it will allow Comcast to run the company with a very small share of ownership. It will also insulate this non-owner management from the ultimate form of ownership discipline – getting fired – for an extremely long period of time. **AT&T/Comcast is predicated on responsibility without ownership.**

> The deal's Achilles' heel may be Comcast's plan to subjugate AT&T shareholder voting rights to management's effective control of the combined entity with only about 1% of the economic interest. Comcast wants to bundle approval of the AT&T Btroadband merger with several anti-shareholder protection provisions; preventing removal of management for eight years, no combined board meeting until 2005, and limits of 10% stock ownership without board approval.[61]

The Enron debacle and numerous other examples of the mistreatment of stockholders by irresponsible management sheds a very harsh light on these legal devices to divorce ownership from control and responsibility. The total abdication of responsibility in these deals can be underscored by the noting that AT&T prided itself on the fact that the board of one its subsidiaries never met. The new deal precludes the board from meeting for three years.

Before the AT&T/MediaOne merger was approved, we pointed out that Liberty has been spun off and pulled back so many times its corporate logo should be a YoYo. We get the feeling of déjà vu all over again. AT&T's spin off of its stake in Liberty as a ploy to come into compliance with the Commission rules entailed the retention by Liberty of significant carriage rights on AT&T systems. John Malone, who controls Liberty, is seeking

to activate his ownership in AOL Time Warner, in which AT&T continues to hold a substantial stake.

AT&T continues to play a game with its stake in Cablevision. It claims to have reduced its voting share to 4.98% to get below the 5% attribution limit, but it owns more in non-voting stock.

It is time for the FCC and other federal agencies to demand that stock ownership be restored to its simple and direct meaning. The FCC should reject these manipulated stock gimmicks. That would stop the merger in its tracks. It would require substantial divestiture of stocks and a complete restructuring of the deal.

C. AT&T/COMCAST WILL NOT BE IN COMPLIANCE WITH THE HORIZONTAL OWNERSHIP LIMIT OF 30 PERCENT OF THE NATIONAL MULTICHANNEL VIDEO MARKET

ATT says it will be in compliance with the 30 percent rule (attributable ownership of 29.87% of the MVPD market) when the merger closes. This claim is based on a series of flimsy assumptions and promises. AT&T claims that it has reduced its ownership in Cablevision to 4.98% (to get under the 5% attributable level). It has irrevocably renounced its right to appoint board members. It promises to disentangle itself from Time Warner.

It has assumed a huge, and historically unprecedented, growth in the multichannel video market in the last six months (during a recession) to inflate the total number of households that receive cable or satellite services. It has also double-counted households that subscribe to both cable and satellite.

---

[61] Scott C. Cleland, *Cable Valuations & Comcast – AT&T Deal on Wrong Side of Change,* Precursor Gropup, April 18, 2002.

- ***If any one of these assumptions were wrong or unfulfilled, AT&T/Comcast would violate the 30 percent limit.*** (Exhibit 12)

The evidence overwhelmingly indicates that AT&T/Comcast would not be in compliance.

AT&T claims that the market for MVPD subscribers has grown about 50 percent faster in the past six months, in the midst of a recession, than it did in the previous four years, one of the longest and strongest boom periods in the past half century. While the market was expanding at this historically unprecedented pace, the four major entities in which AT&T claims an attributable ownership interest were contracting. Even if we exclude AT&T, which may have been selling off systems, the three other entities (Time Warner, Insight and Comcast) were essentially stagnant. The claimed market expansion is inconsistent with the evidence. If we assume the MVPD market continued to expand at historic rates, and most observers believe its growth is slowing, AT&T would be in violation of the 30 percent limit.

AT&T (and the FCC) use an approach that double counts households that subscribe to both cable and satellite. The FCC assumes that the number is "expected to be low." However, there are several solid sources of data that indicate the number is between 2 and 2.5 million, or 2 to 3 percent of the market. Since AT&T/Comcast are clearly playing a game of compliance by hundredths of a percent, the double count becomes extremely important.

Under every scenario we examined, AT&T/Comcast exceeds the 30 percent limit by a larger margin that it claims to below the limit.

D. THE PUBLIC UNDERSTANDS THE DANGER OF MERGERS IN THE MASS MEDIA AND COMMUNICATIONS INDUSTRIES

The previous regulatory analysis is framed in the complex terms of economic analysis that is grounded in theory and empirical research. The conclusion is clear, the public is poorly served by increasingly concentrated media and communications markets created by these mergers. The public bears the brunt of this market failure in the form of rising prices and poor service. Public opinion toward mergers is shaped by that real world experience of consumers.

In response to survey questions the public expresses strong concerns about increasing size and concentration in the media and communications industries. With respect to the AT&T/Comcast merger, two thirds of the respondents to one recent survey said that the AT&T/Comcast merger should be denied.[62] The most frequent problem volunteered by respondents with communications industry mergers was the lack of choice and competition (34 percent). The second most frequent problem was higher prices. The sheer size of the companies was a distant third (9 percent).

The public has taken this dim view of communications industry mergers for some time. In late 1995, just prior to the passage of the Telecommunications Act, the Consumer Federation of America and the Center for Digital Democracy commissioned a national public opinion poll on this subject.[63] Without a specific merger in mind, 54 percent felt public policy should make it harder for cable mergers to take place. Half the respondents felt the mergers would lead to higher prices, compared to only one-eight who felt prices would go down. By more than a two-to-one margin, respondents believe that quality will become worse, not better (36% v. 14%).

---

[62] *Cable/Satellite Television Survey* (Lauer Research Inc, March 2002).

E. CONCLUSION

Under any reasonable interpretation of either the Communications Act or the antitrust laws, this merger should be rejected. The failure of the DOJ and the FCC to enforce their rules has resulted in substantial harm to consumers. This merger would make matters much worse, creating a huge national entity with consolidated control over important regional markets. Federal authorities have let consumers down.

There is a simple principle that applies to the industry: 'if you let them, they will merge. If you do not let them, maybe they will compete.' These companies clearly have a mandate for growth. If they were not allowed to do so through merger and acquisition, they would have to grow through competition. The merging parties have failed to show that the likely benefits of the merger exceed it harms. To the contrary, there are virtually no demonstrable and verifiable public interest benefits that could not be achieved if there were no merger and substantial public interest harms of the merger.

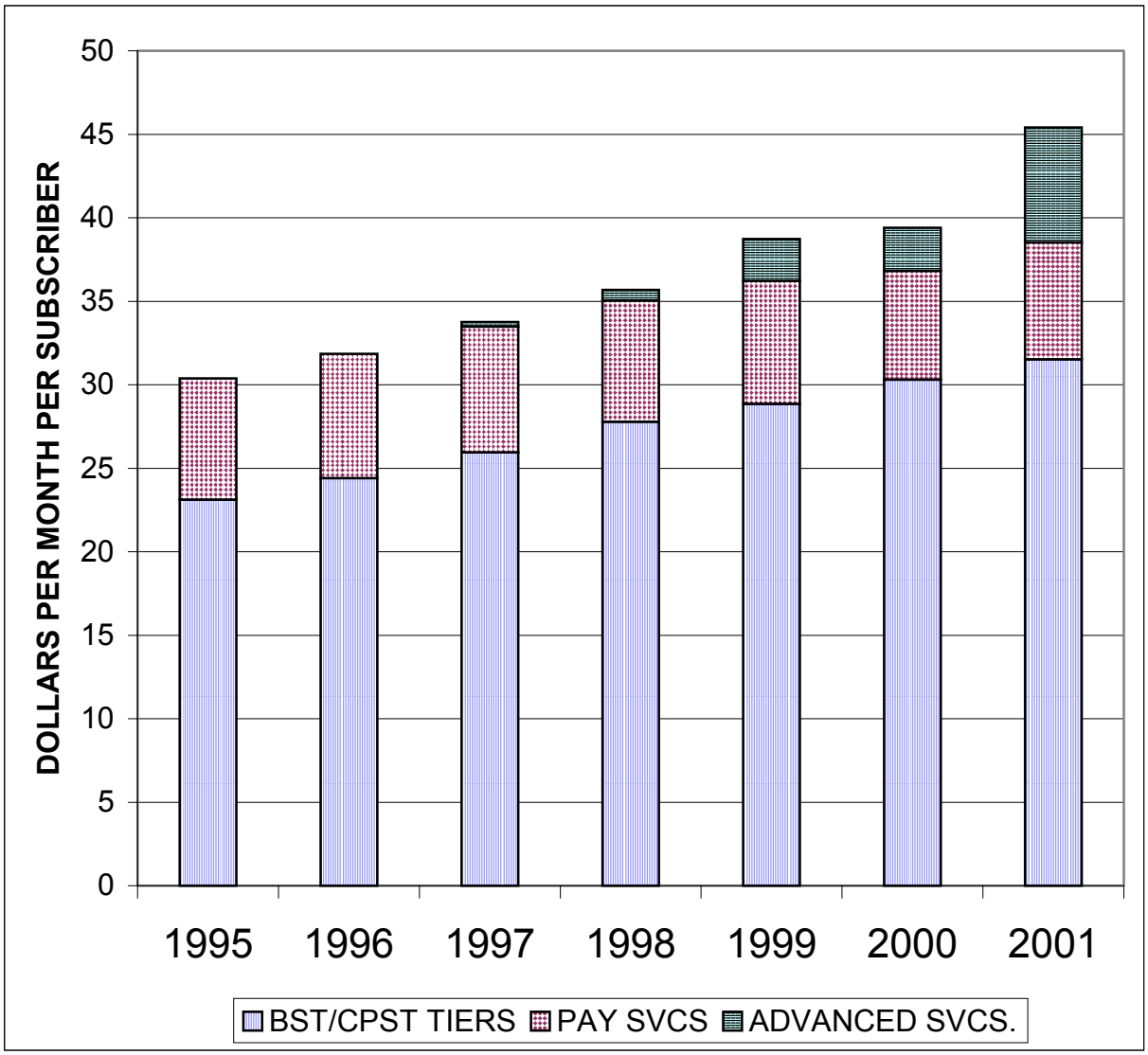
The fact that the last, bad merger was approved on the basis of the same false promises should not be justification for approval of the next bad merger. To the contrary, it is about time that the Commission learned the obvious lesson. The highly concentrated cable industry possesses market power and these mergers are making it worse. Enough is enough. This merger must be denied.

---

[63] *Mergers and Deregulation on the Information Superhighway: The Public Takes a Dim View* (Consumer Federation of America and Center for Media Education [now the Center for Digital Democracy: September 1995).

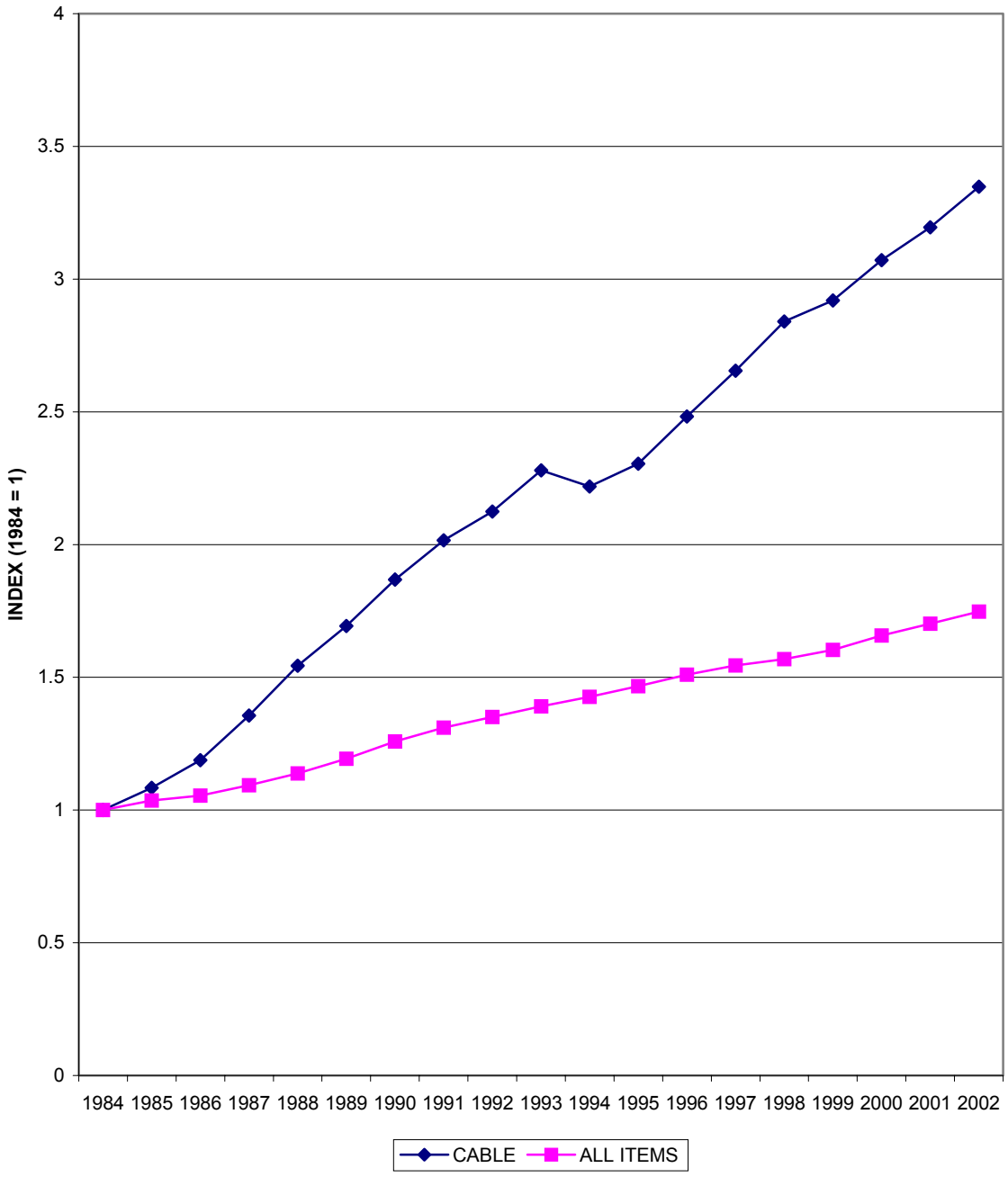
EXHIBITS

EXHIBIT 1: CABLE REVENUE INCREASES AFTER PASSAGE OF THE TELECOMMUNICATIONS ACT OF 1996



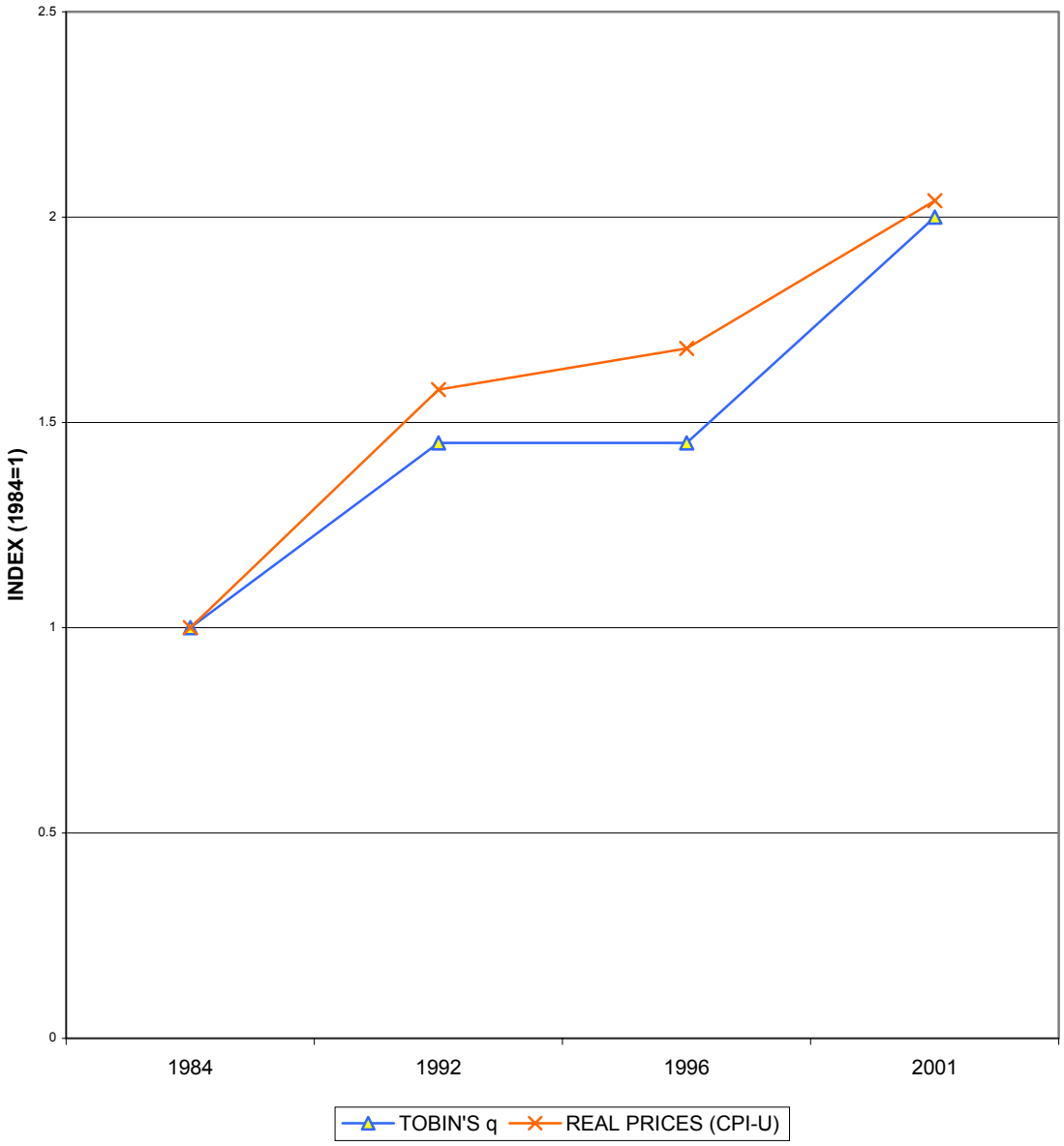
Sources: Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141, December 31, 1997, Appendix B; Sixth Annual Report, CS Docket No. 99-230, December 30, 1999, Appendix B; Seventh Annual Report, CS Docket No. 00-132, January 2, 2001, Appendix B; Eight Annual Report, CS Docket No. 01-129, January 14, 2002, Appendix B.

EXHIBIT 2: PRICE INCREASES SINCE CABLE DEREGULATION IN 1984



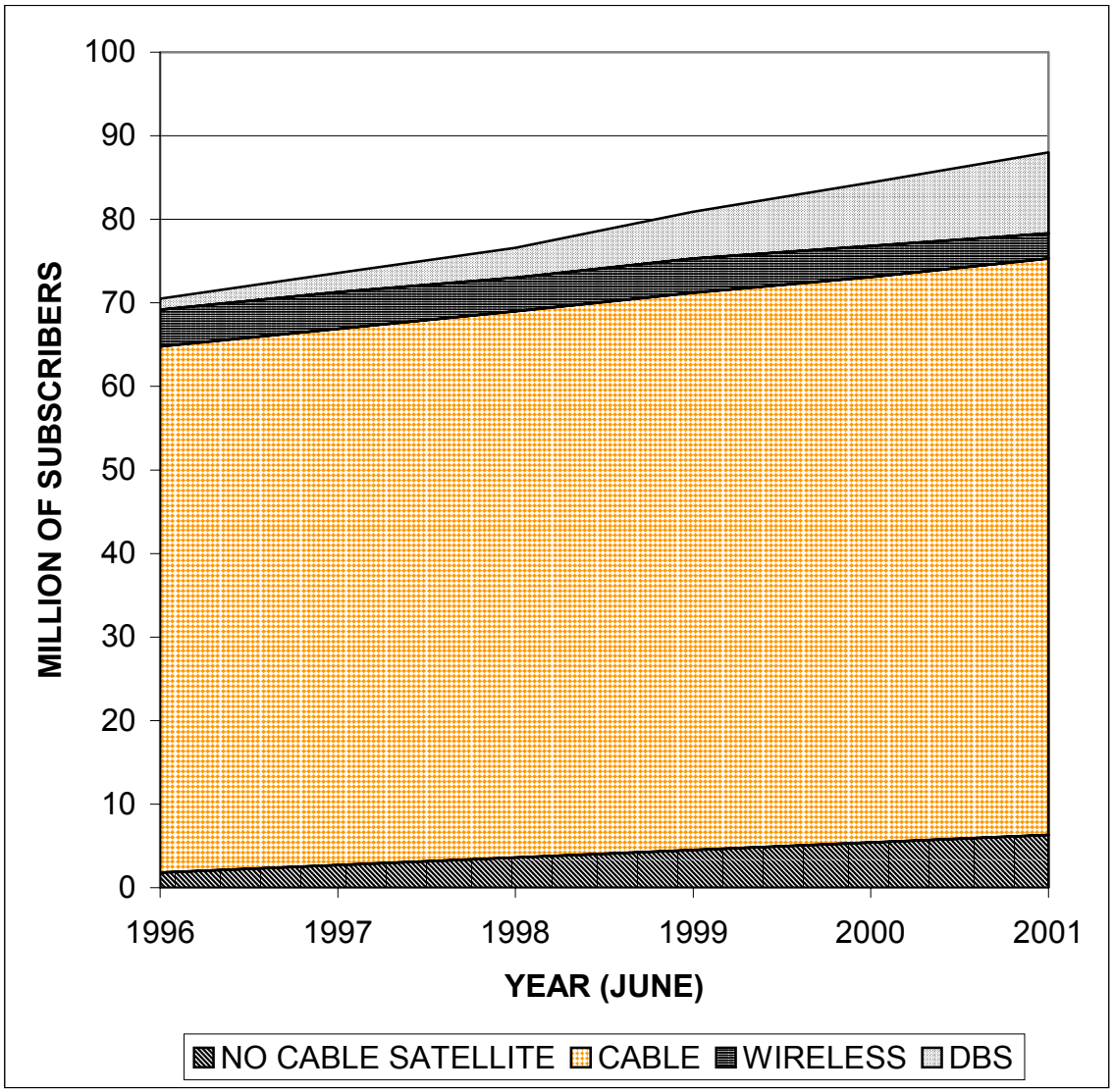
Source: Bureau of Labor Statistics, Consumer Price Index.

EXHIBIT 3: REAL PRICE INCREASES AND MONOPOLY RENTS (TOBIN'S q)



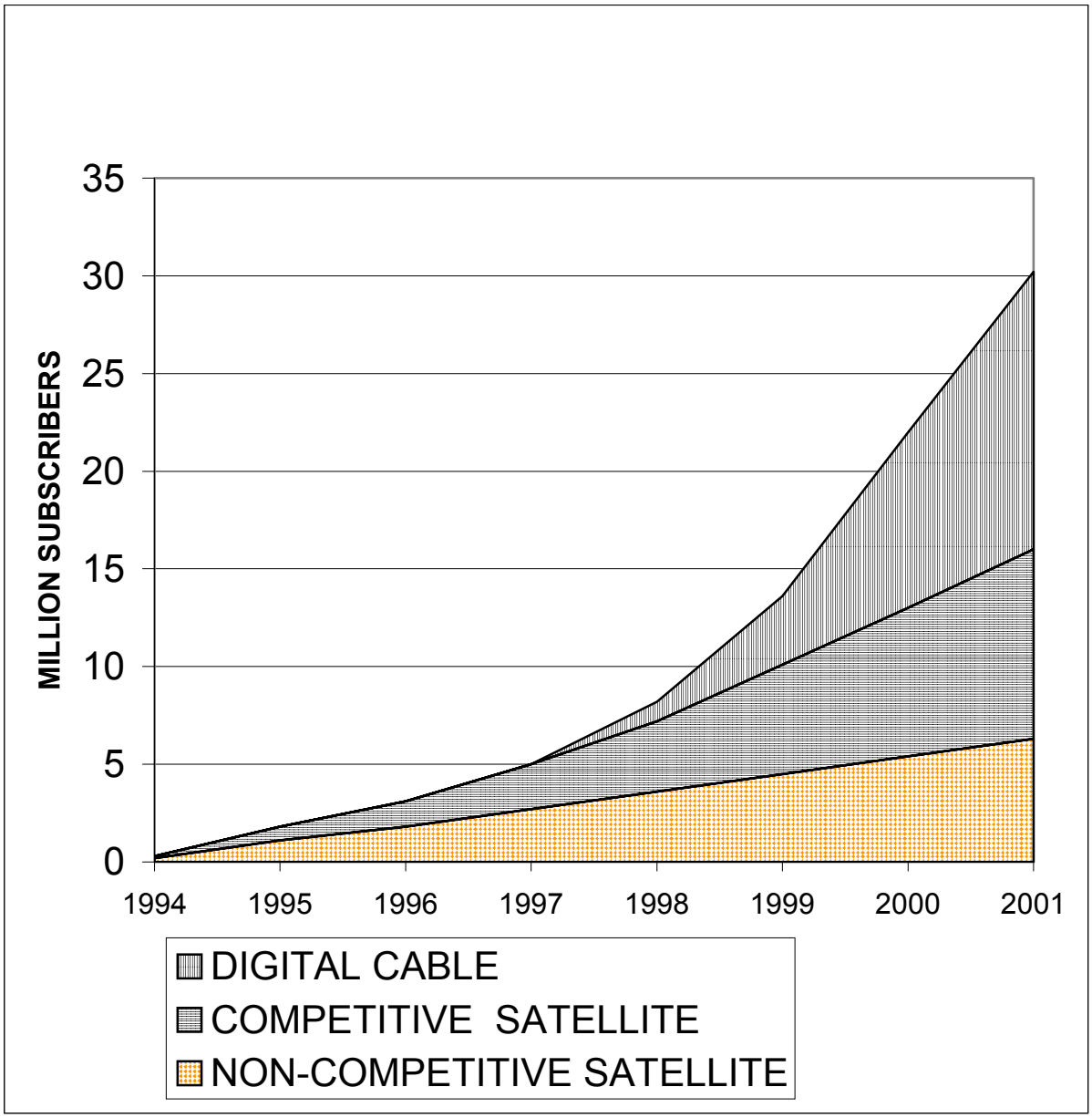
Sources: Real Prices calculated from Exhibit 2; Tobin's q calculated from Comments and Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," in *Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002, February 19, 2002.

EXHIBIT 4: MULTI-CHANNEL VIDEO PROGRAMMING DISTRIBUTORS



Sources: Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141, December 31, 1997, para 36; Sixth Annual Report, CS Docket No. 99-230, December 30, 1999, para 54; Seventh Annual Report, CS Docket No. 00-132, January 2, 2001, para 66; Eight Annual Report, CS Docket No. 01-129, January 14, 2002, paras 38, 58. Competitive Satellite is 60 percent of DBS in 2001 and 40 percent in 1994, with the percentages assumed to change smoothly between the two dates.

EXHIBIT 5: CABLE'S DRAMATIC CAPTURE OF THE DIGITAL TV MARKET



Sources: Source: Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 26; Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141, December 31, 1997, para 36; Sixth Annual Report, CS Docket No. 99-230, December 30, 1999, para 54; Seventh Annual Report, CS Docket No. 00-132, January 2, 2001, para 66; Eight Annual Report, CS Docket No. 01-129, January 14, 2002, paras 38, 58. Competitive Satellite is 60 percent of DBS in 2001 and 40 percent in 1994, with the percentages assumed to change smoothly between the two dates.

EXHIBIT 6: LAYERS IN THE COMMUNICATIONS PLATFORM

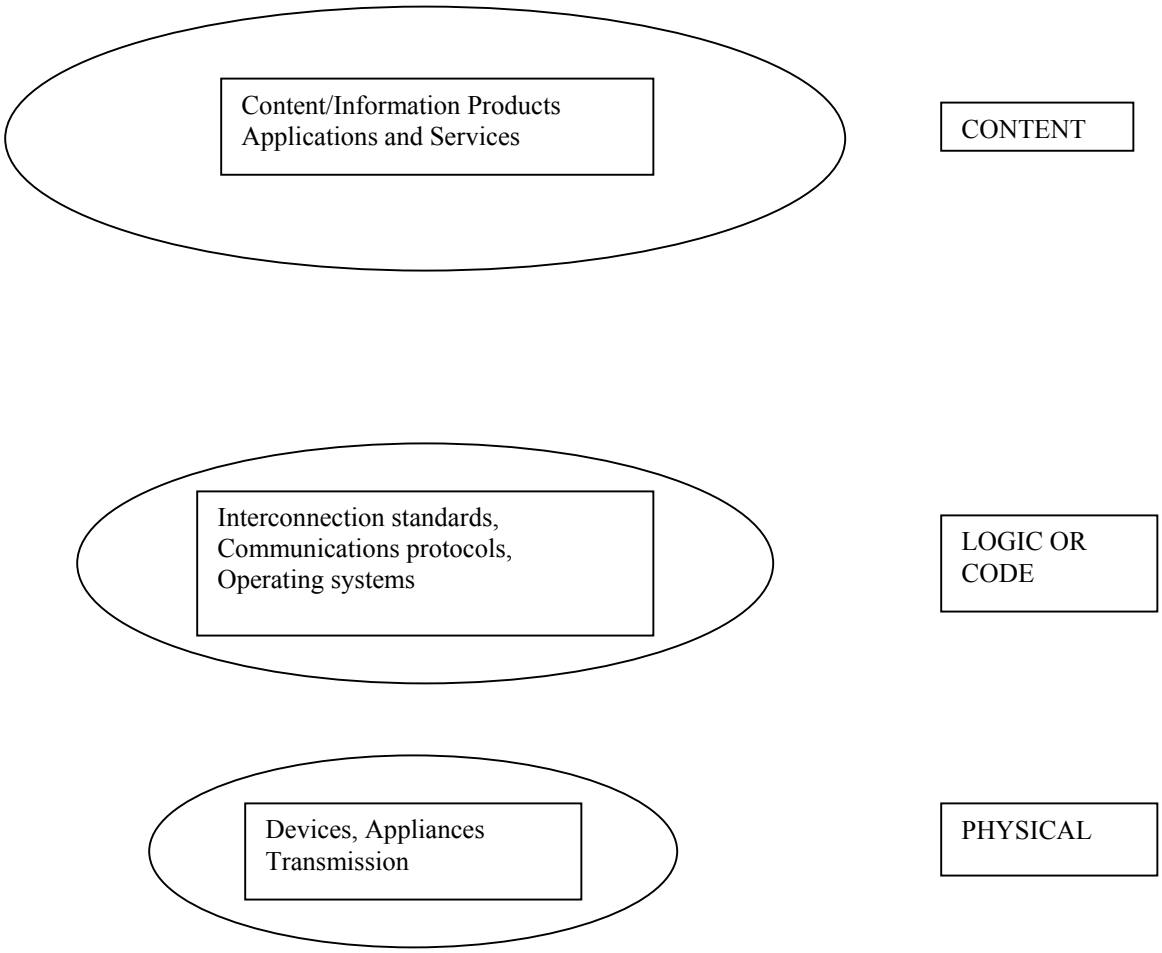


EXHIBIT 7:

ANTI-CONSUMER/ ANTICOMPETITIVE ELEMENTS OF THE CABLE INDUSTRY COMMUNICATIONS PLATFORM

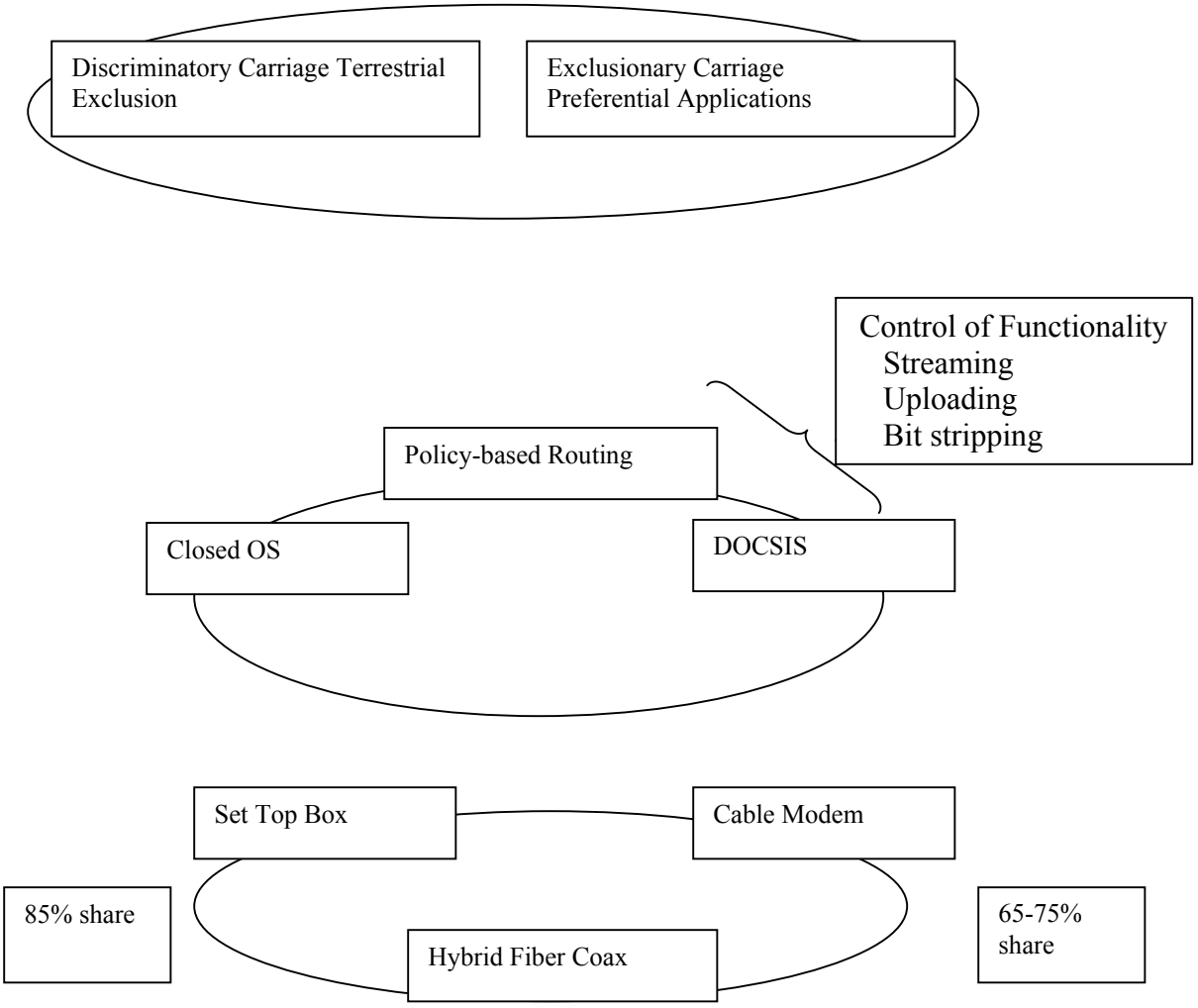


EXHIBIT 8: HORIZONTAL AND VERTICAL ANTI-CONSUMER/ ANTICOMPETITIVE IMPACTS OF THE AT&T/COMCAST MERGER

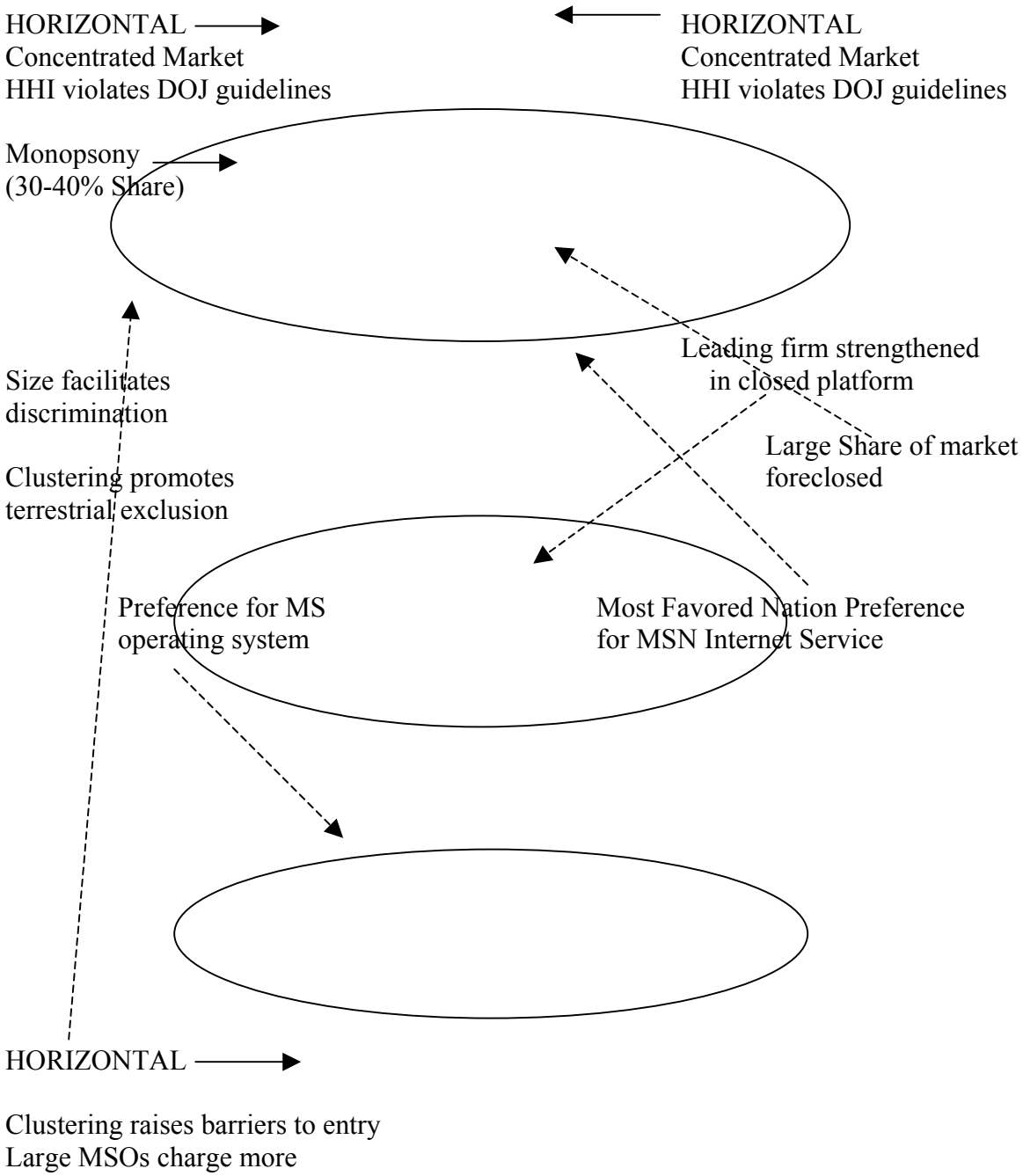
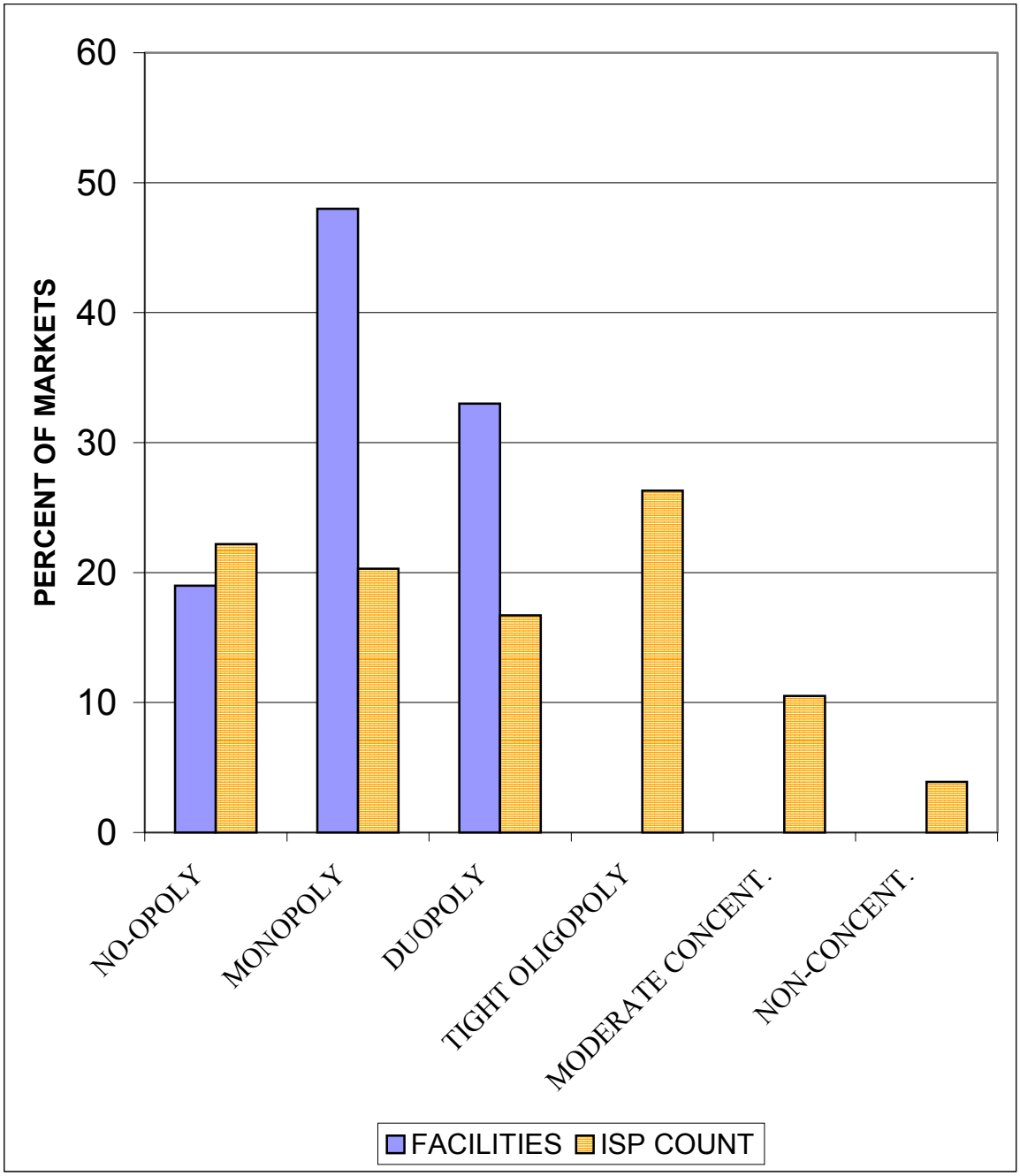
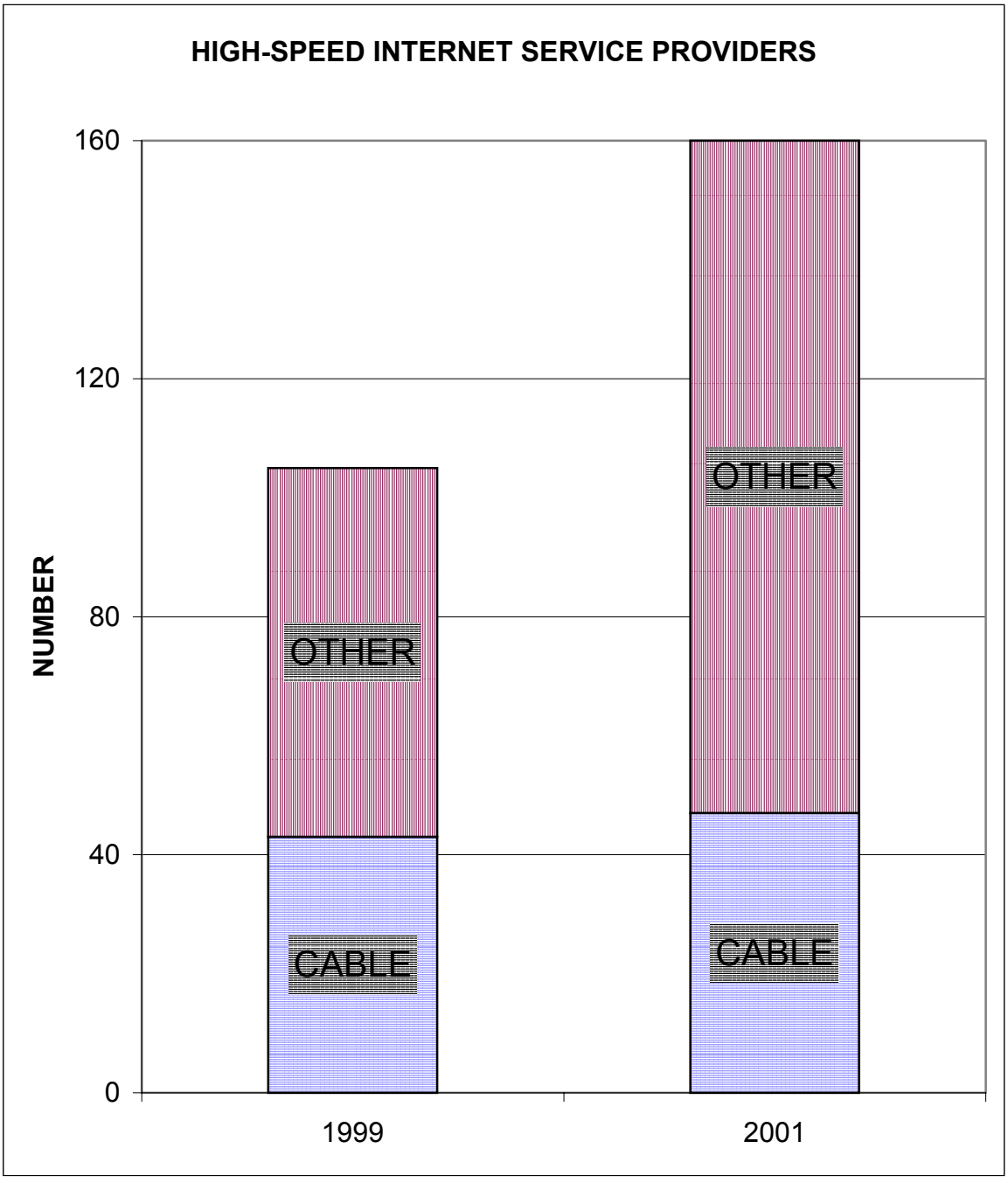


EXHIBIT 9: MARKET STRUCTURE OF HIGH-SPEED INTERNET ACCESS SERVICE



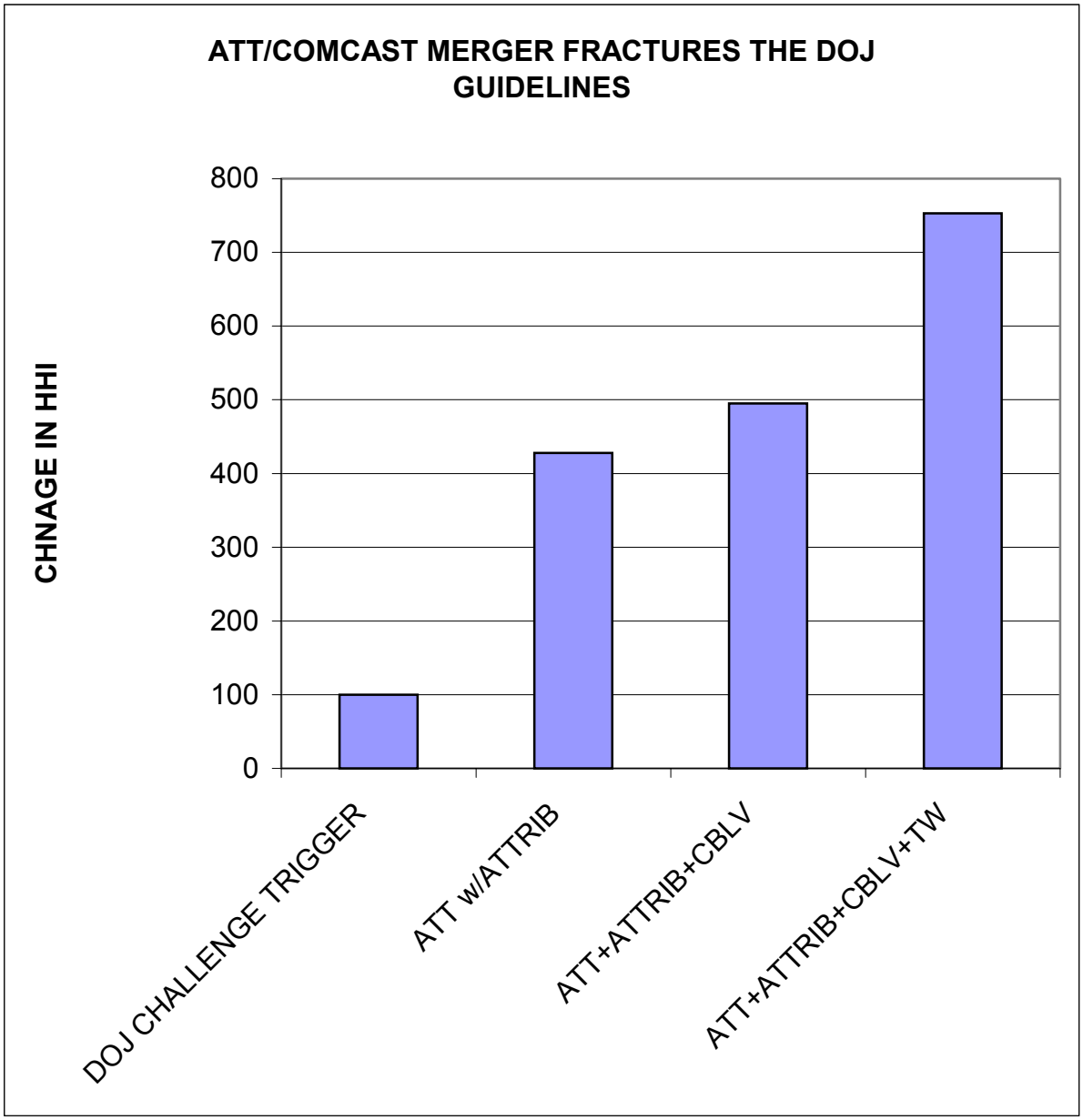
Sources: Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Table 9; Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 36.

EXHIBIT 10:



Source: Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Tables 1,2,3,4.

EXHIBIT 11:



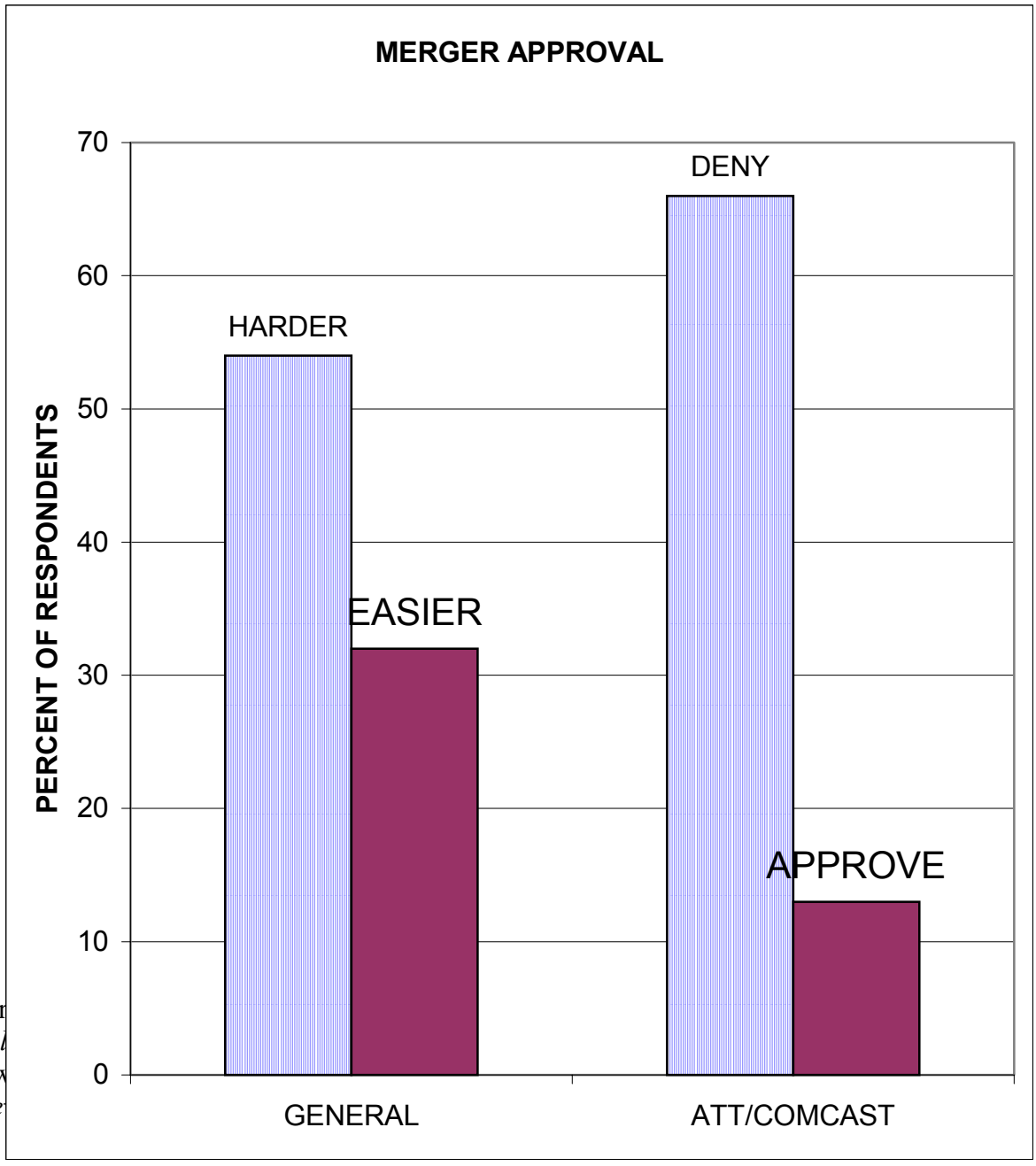
Sources: U.S. Department of Justice, *Horizontal Merger* Guidelines, revised April 8, 1997, for a discussion of the HHI thresholds. Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Eight Annual Report, CS Docket No. 01-129, January 14, 2002, Table C-3; "Application and Public Interest Statement," *In the Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (hereafter, Application); HHIs are calculated with an unduplicated count of 86 million MVPD subscribers. ATT w/ Attrib is 18.8 million. Comcast is 8.4 million. Cablevision is 3 million. TW is 11.35 million.

EXHIBIT 12: AT&T/COMCAST WILL NOT BE IN COMPLIANCE WITH THE 30 PERCENT HORIZONTAL LIMIT

	DOUBLE COUNT	SINGLE COUNT
MVPD MARKET SIZE (millions of subscribers)		
ATT - /01/02	91.30	89.00
HISTORIC – O1/02 GROWTH RATE	90.20	87.90
FCC - 06/01 DATA	88.30	86.00
.		
ATT/COMCAST MARKET SHARE IN PERCENT		
(ATT CLAIMS OF OWNERSHIP = 27.28 MILLION)		
ATT - /01/02	**29.88**	30.65
HISTORIC - O1/02 GROWTH RATE	30.24	31.04
FCC - 06/01 DATA	30.89	31.72
ATT/COMCAST MARKET SHARE IN PERCENT		
(WITH TIME WARNER= 38.63 MILLION)		
ATT - /01/02	42.31	43.40
HISTORIC - O1/02 GROWTH RATE	42.83	43.95
FCC - 06/01 DATA	43.75	44.92
ATT/COMCAST MARKET SHARE IN PERCENT		
(WITH CABLEVISION = 30.28 MILLION)		
ATT - /01/02	33.17	34.02
HISTORIC - O1/02	33.57	34.45
FCC - 06/01	34.29	35.21
ATT/COMCAST MARKET SHARE IN PERCENT		
(WITH TIME WARNER& CABLEVISION = 41.63 MILLION)		
ATT - /01/02	45.60	46.78
HISTORIC - O1/02	46.15	47.36
FCC - 06/01	47.15	48.41

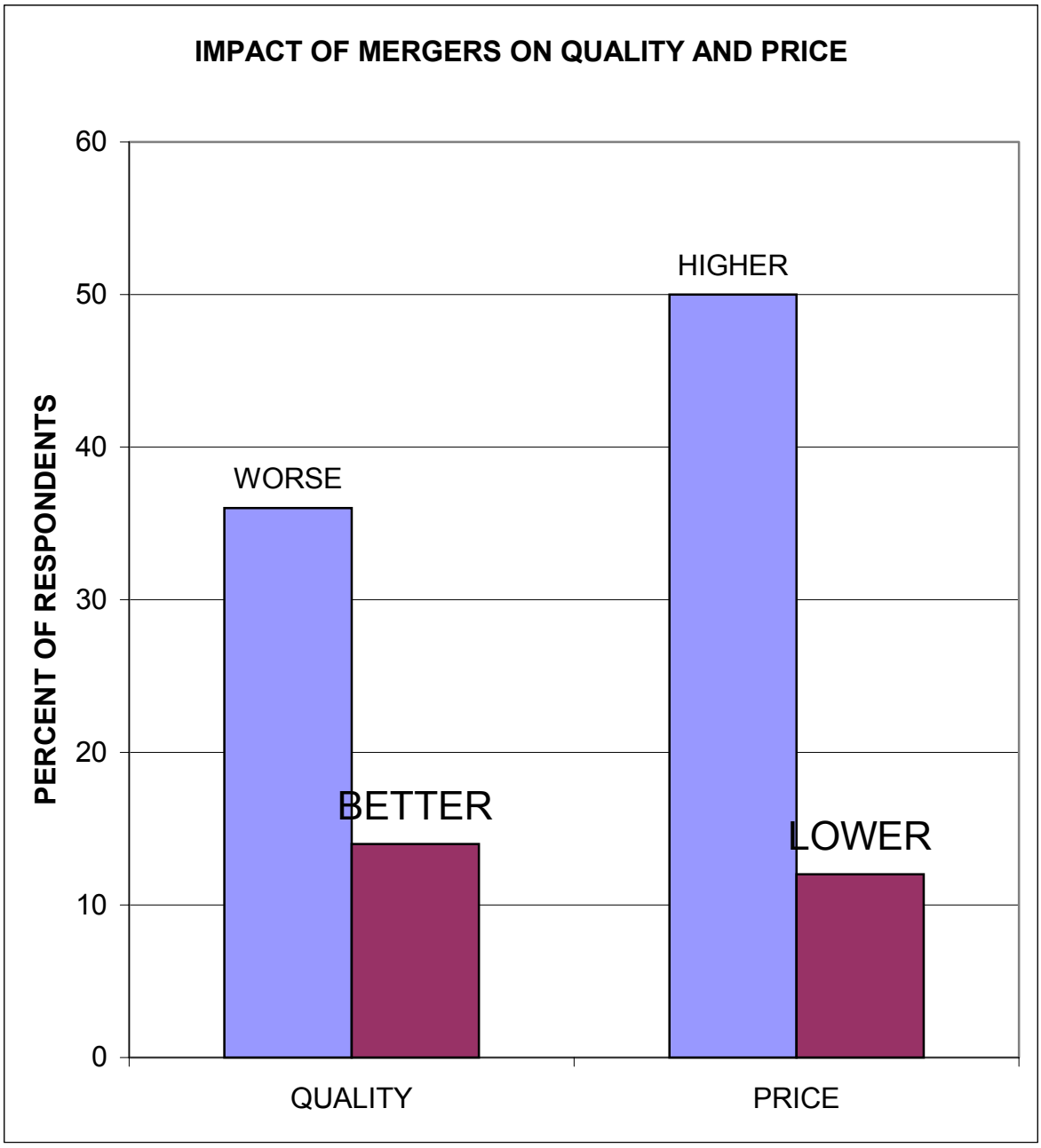
Source: "Application and Public Interest Statement," *In the Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (hereafter, Application), pp. 49-51, for AT&T claims. Federal Communications Commission, Eight Annual Report, Table C-1 for historic growth rates; C-3 for Cablevision subscribers. Single count assumes 2.3 million dual households. Historic growth assumes 1.9 million increase in MVPD households 06/01 to 01/02.

EXHIBIT 13: THE PUBLIC OPPOSES MERGERS IN THE MEDIA AND COMMUNICATIONS INDUSTRIES



Sour
Publ
[now
Tele

EXHIBIT 14: THE PUBLIC RECOGNIZES THAT MERGERS RAISE PRICE AND LOWER QUALITY



Source: *Mergers and Deregulation on the Information Superhighway: The Public Takes a Dim View* (Consumer Federation of America and Center for Media Education [now the Center for Digital Democracy: September 1995).

NEW MEDIA, NEW CONTROLS:
AT&T COMCAST'S HOLD ON THE BROADBAND FUTURE

SPECIFIC INDUSTRY TECHNOLOGY AND TRENDS AGRAVATED BY THE MERGER

As discussed at length in the *Petition* and Attachment A, the merger of Comcast and AT&T Broadband will create an entity capable of creating an architecture that locks in closed, proprietary systems and makes the innovation and civic discourse now the hallmark of the Internet impossible. This attachment serves three purposes:

- It provides supporting evidence of the economic analysis by describing the existing technology and capacity to facilitate anti-competitive practices and control the dissemination of information.
- It explains how the merger of Comcast and AT&T aggravates these trends by creating a single entity able to dictate first to the equipment market (through the ability to block sale of cable equipment to nearly 50% of the market) and then to the content, service, and information providers (once the gateways are in place).
- It documents a striking example of the existing ability of Comcast, as the third largest cable operator in its own right and prospective owner of AT&T Broadband, to extort equity shares from equipment providers. Because this closely resembles practices Congress sought to address through the horizontal ownership limit, *see* Cable Television Consumer Protection Act of 1992, Pub. L. No. 102-385, §11(f), the Commission must treat the danger of Comcast AT&T exercising such market power with particular concern.

LEVERAGE OVER THE CODE LAYER OF THE DIGITAL COMMUNICATIONS PLATFORM

Operating systems and communications software that control the flow of data and information are at the center of the digital communications networks that are now being deployed by cable operators. The importance of how these flows are controlled increases with the functionality of these networks.

The cable industry's longstanding role as gatekeeper, generally restricting multi-channel video programming to fixed menus of branded, mainstream entertainment, has been well documented. With the advent of much more powerful, two-way digital networks, however, that role must now be re-examined. Simply put, the more intelligent the *gate* (and the latest set-top boxes are equipped with hard disks, modems, and CPUs), the more important it is that MSOs not be permitted to abuse their gatekeeping powers. And the more valuable the programming and services on the *other side* of cable's gates (services that now include advanced telecommunications via broadband connections to the home), the more significant is the role that regulators and elected officials must play in defining and defending the public interest. With a company of the sheer size and market clout of AT&T Comcast—whose influence, for better or worse, now extends into the marketplace of ideas as well—this review is critical.

> Major cable operators, including Comcast and AT&T, enjoy such significant control over their multi-channel distribution platforms that they can both extract concessions from unaffiliated programmers as well as secure favorable treatment for their own content affiliates. Now these major MSOs are poised to extend that market power to other aspects of their high-speed networks, including the logical and physical layers (application software and transport mechanisms, respectively).

COMCAST ALREADY POSSESES SUFFICIENT MARKET POWER TO EXTORT EQUITY STAKES FROM EQUIPMENT MANUFACTURERS AND SERVICE PROVIDERS IN THE SAME WAY THAT CABLE MSO'S EXTORTED THEIR CONTROL OVER THE PHYSICAL LAYER TO EXTORT EQUITY FROM PROGRAMMERS BEFORE THE 1992 CABLE ACT.

As the third largest cable company and prospective purchaser of AT&T Broadband, Comcast already exercises sufficient market power to exact significant concessions from would-be equipment and service providers. Comcast recently required two of its broadband service providers (Concurrent and SeaChange) to give Comcast valuable stock warranties as

part of its purchase of video-on-demand (VoD) equipment. Concurrent issued to Comcast an "initial warrant" of 50,000 shares of common stock and "performance warrants" in excess of 56,000 shares.[64] Under a similar arrangement with SeaChange (after the purchase of technology for 1 million VoD systems), Comcast received warranties for over 500,000 shares of SeaChange stock at a total purchase price of over $12 million.[65] Thus, by leveraging this control over the content, physical, and logical layers of its broadband cable networks, Comcast has also succeeded in penetrating the *financial* layer of some if its key service providers, an unprecedented exercise of power that should certainly come under Commission scrutiny in the course of its merger review.

This practice bears a stark resemblance to the manner in which large cable MSOs used their control over the physical cable plant to extort equity shares from cable programmers prior to the 1992 Cable Act. *See* S. Rep. 102-92 at 24, 29 ("Senate Report"); H.R. Rep. 102-862 at 41 ("House Report"); 138 *Cong. Rec.* S.421 (January 27, 1992). Cable operators would then use their equity stakes in programmers to deny carriage of valuable programming to rivals. Senate Report at 26-29; House Report at 41.

Even companies large enough to resist a demand for equity shares may find itself unable to escape the dominance of the new AT&T Comcast. The huge size of the merged entity would greatly facilitate the effort to control and frustrate competition in the code layer. AT&T Comcast will control such a substantial part of the market that it would easily provide a base for tipping the market to whatever standard AT&T/Comcast prefers.

Congress ordered the Commission to create limits on cable ownership as a prophylactic measure to prevent this kind of exercise of market power. Senate Report at 23,

[64] 10 Q, February 14, 2002, Securities and Exchange Commission

32-34. Because Congress has identified this as a core concern for the Commission to address, and because history demonstrates that the cable MSOs will leverage their market power if permitted, the Commission must reject the Application as contrary to the public interest.

CRITICAL NEW AREAS OF CONCERN.

The potential market power that AT&T Comcast would posses raises concerns in the following specific areas that the Commission must carefully scrutinize.

Set-top box design and deployment: Comcast is now completing a major integration of its set-top box operating system software, electronic program guides, data collection, billing, and video-on demand distribution network. Among Comcast's partners are many of the leading suppliers of multimedia technologies, including Scientific-Atlanta, Motorola, Gemstar, SeaChange International, Concurrent Computer Corp, and Cabledata.[66] As this comprehensive strategy will be extended across the AT&T cable empire if the merger is finalized, the potential consolidation and control of cable's architectural capabilities could pose serious competitive obstacles to meaningful video-on-demand and other digital media markets.

Similarly, Comcast's role in Cablelabs – where Mr. Roberts is currently vice-chair and formerly served as chair – provides an additional opportunity for Comcast to influence standards. The Commission should examine Comcast's influence over Cablelabs and Cablelabs' role in developing standards carefully, considering the failure of the cable industry to fulfill the Congressional mandate for commercial availability of cable set-top box equipment. Comcast partners AT&T and AOL Time Warner also figure prominently on the

---

[65] 10Q, December 13, 2001,

[66] <http://www.broadbandweek.com/news/011105/print/011105_cable_comcast.htm>.

board of Cablelabs, which appears to be doing more to protect the hegemony of leading MSOs than to promote open standards, interoperability, and consumer choice.[67]

Personal Video Recorders: Personal Video recording (PVR) will increasingly become standard in emerging set-top boxes, such as new Motorola models from both the DCT-2000 and DCT-5000 series. Set-top integrated PVR's, connected to the cable head-end, will give AT&T Comcast an advantage over other programmers through its direct access to both the PVR hard drive as well as extensive databases of customer information. The Commission must ensure that competition from programmers and other information providers can emerge in the PVR market, and that AT&T Comcast will not be able to leverage its dominant position with equipment manufacturers and its network to penalize competitors.

Interactive Television: AT&T Comcast is also in a position to shape the evolution of interactive TV services. As the Commission knows, ITV will combine the two platforms of television and Internet communications, permitting users to engage in a variety of interactive services, including email, chat, instant messaging, and e-commerce. Typical of Comcast's aggressive behavior in this emerging arena is Comcast Interactive Capital, a $350 million venture capital fund with wide-ranging investments in broadband services, telecommunications, electronic commerce, and entertainment.[68] AT&T Comcast will thus be able to determine how competitive and non-discriminatory the market for ITV services will be for millions of subscribers. Comcast's alliance with MetaTV, for example, promises to deliver an ITV system that will "[g]enerate new revenue streams…, [e]nable real-time

[67] <http://www.cablelabs.com/about_cl/directors.html>.
[68] <http://www.civentures.com/>.

transactions…, [i]ncrease brand awareness and loyalty…, [and] [d]ata-mine viewing habits…."[69]

Comcast has also ordered 300,000 Pace 700 series set-top boxes, which contain an integrated cable modem. This box can support multiple middleware applications, including MediaHighway, OpenTV, PowerTV, Liberate Technologies, and Microsoft TV. AT&T Comcast will be in a position to determine the extent to which competing middleware ITV programming will be able to utilize their platform. Moreover, given the recently announced relationship between AT&T Comcast and Microsoft, there is a very real danger that the company will close off avenues for potential competition.[70]

Electronic/Interactive Program Guides: In March 2001, Comcast entered into a relationship with Gemstar to provide interactive program guide (IPG) services. Gemstar also has a relationship with AT&T. In light of the role that the IPG plays in influencing consumer choice, it is critical that there are no barriers that would deter fair competition in the promotion of programming that competes or is unaffiliated with AT&T Comcast. Since AOL Time Warner also utilizes the Gemstar product, and considering the current financial relationship established through joint ownership with AT&T in Time Warner Entertainment, there is also a serious concern about a partnership or reciprocity arrangement between these two cable behemoths that could stifle competition.[71]

Video-on-Demand: Comcast has a clear advantage in this emerging marketplace, and the merger is likely to further harm competition. For example, InDemand, the pay-per view company owned by a number of MSOs (including Comcast, AOL Time Warner, Cox, and

---

[69] <http://www.metatv.com/solutions/cable.htm>.

[70] <http://www.broadband-daily.com/subscribers/index.htm?article_id=3053>, <http://www.broadband-daily.com/subscribers/index.htm?article_id=3255>.

AT&T), has made substantial inroads with content suppliers (including Warner Bros. and Universal). The "lethal advantage," as *Cableworld* magazine describes it, that InDemand has in the market can be inferred from the recent announcement from leading competitor Diva which, according to *Cableworld*, has informed the SEC that it has only enough cash on hand to see it through to June. Diva was able, however, to secure some Video on Demand deployments with AT&T Broadband and Insight cable. The merger of AT&T and Comcast poses a serious problem in the VOD arena, and must be investigated by the Commission.[72]

Content: According to Comcast President Steve Burke, the company hopes to utilize its broadband platform for such services as "video chat" and "video gaming." Burke told the UBS Warburg Media Week Conference on December 4, 2001, that the company's "…infrastructure is superbly tailored to support video gaming."[73] Given Comcast's plans to unveil its new "G4" cable TV network focused on the gaming market (which, they note, involves some 145 million Americans in computer and video games), there is the potential for the company to place competitive barriers in the online and broadband gaming industry as well. In addition to video programming concerns, there may also be preferential treatment given to the G4TV.com Web site.[74]

Privacy: The Commission must ensure that digital privacy is protected, as it articulated in its own findings in the merger of AOL and Time Warner. Recently, both members of Congress and the public have expressed concerns about the collection of IP addresses with Comcast

---

[71] <http://www.gemstartvguide.com/pressroom/display_pr.asp?prId=112>.

[72] <http://www.inside.com/product/product.asp?entity=CableWorld&pf_ID=549BAF8C-5917-4A01-91C4-B32477EB8117>.

[73] <http://www.broadband-daily.com/subscribers/index.htm?article_id=3055>.

[74] "Comcast Announces New Video Game Television Network: G4," Nov. 28, 2001, Press Release, available at <http://www.comcast.com>.

cable modem services.[75] At the time, Comcast Cable Communications President Stephen B. Burke issued the following statement regarding Internet privacy:

> Comcast respects the privacy of all our subscribers and is committed to fully protect their rights. Comcast has not shared and will not share personal information about where our subscribers go on the Web, either for any internal purpose or with any outside party, except as required by law. Consistent with our subscriber agreement and our privacy policy, which every subscriber acknowledges before receiving our service, Comcast reviews information in aggregate form only for purposes of network performance management to ensure an optimal Internet network experience for our subscribers.[76]

However, there appear to be other areas where Comcast may be collecting cable TV or cable modem subscriber information in violation of this promise. For example, Comcast has deployed the "DST Innovis Data Warehouse Tool," with which Comcast plans to "leverage the powerful data warehouse tool for planning, trend analysis and marketing." According to a Comcast official, these new tools will provide the company with "an in-depth understanding of its customers." The DDP/SQL database function provides Comcast with clear advantages over other content providers in shaping the purchase of various types of programming, including "high-speed data services, video-on-demand, electronic services, web-over-TV, and traditional cable television services," by "…researching and understanding customer's buying habits, history, and attributes." Similarly, Comcast can "track and record inbound and outbound customer interactions…," and identify "customer demographics, buying behaviors, and purchasing patterns…." The data-collection and -mining tools that Comcast has deployed clearly will give it an advantage over its content competitors, since the DST Intelecable service can also "implement flexible pricing strategies without programming intervention, including usage, metered, and subscription rating of events and transactions." The software is

---

[75] <http://www.informationweek.com/story/IWK20020215S0018>.

[76] Comcast press release, Feb. 13, 2002, available at <http://www.comcast.com>.

also designed to give Comcast the ability to engage in "segmenting and profiling buying behavior."[77] In conjunction with MetaTV, moreover, Comcast may employ a Universal Portal Platform featuring data collecting and reporting capabilities that "provide network operators, advertisers, merchants and broadcasters with analytics to measure and track the effectiveness of ad campaigns, content viewing and navigation assessment."[78] MetaTV permits cable operators to "data-mine viewing habits. Through two-war interaction (network operators can) access real-time subscriber data." Comcast Interactive Capital has invested in MetaTV.[79]

The proposed AT&T Comcast and Microsoft partnership in ITV also raises potential privacy issues. Microsoft (which has been promised that it may deploy its ITV software on up to 25 percent of the AT&T Comcast systems) announced last December its plans to deploy TV personalization software from Predictive Networks.[80] This software will create a "digital silhouette" of users, permitting "viewer behavioral profiling." Through the "use of TV clickstream data and artificial intelligence algorithms … each digital silhouette comprises over 180 demographic and content affinity categories…."[81]

CONCLUSION

All of these issues, clearly, warrant the close scrutiny of the FCC. While AT&T Comcast may blithely refer to "[s]cale and scope efficiencies and cost savings generated by

---

[77] <http://www.dstinnovis.com/solutions/sol_cmb_ddp.htm>, <http://www.dstinnovis.com/solutions/sol_cmb_intel.htm>, and <http://www.dstinnovis.com/about/abt_nws_cr_pr032601.htm>.

[78] <http://www.metatv.com/news/new/061101_uppnextgen.htm>.

[79] "MetaTV Solutions for Network Operators," available at: http://www.metatv.com/news/resources.htm.

[80] See the QUIPs agreement, <http://www.fcc.gov/mb/attcomcast/>.

this merger," it is clear that there is much more to this proposed union than marketplace expediencies alone. This merger reaches to the very heart of the broadband revolution, and thus to the heart of that technology's ability to serve ***civic*** as well as commercial ends. The Commission's responsibility in this regard—to reject the merger if the two parties can do no more than pay lip service to the public interest concept—should be clear.

[81] <http://www.predictivenetworks.com/news/press121101.html>.

Consumer Federation of America

Consumers Union

Publisher of Consumer Reports

THE FAILURE OF 'INTERMODAL' COMPETITION IN CABLE AND COMMUNICATIONS MARKETS

Dr. Mark Cooper

Research Director
Consumer Federation of America

April 2002

TABLE OF CONTENTS

EXECUTIVE SUMMARY

This paper demonstrates that cable industry claims about cross technology competition and Federal Communications Commission (FCC) hopes that intermodal competition will discipline market power to create an open, consumer-friendly communications environment cannot be supported by empirical evidence.

- Cable TV has not been disciplined by the presence of satellite in the past and is less likely to face stiff competition from satellite in the foreseeable future.

- Cable modem service currently dominates the residential broadband market and is not likely to be threatened by DSL or wireless broadband Internet access service in the foreseeable future.

With highly concentrated, mostly monopoly or duopoly markets at the point-of-sale for both the multi-channel video programming distribution (MVPD) and broadband Internet access, there is no effective alternative delivery mechanism (either analog nor digital) that can discipline the abuse of market power. As a result prices have been rising, monopoly rents have been mounting and innovation has been slowing.

Fiction in Cable-Satellite Competition

Cable industry claims presented to the FCC about competition at the point-of-sale in the MVPD market are a mixture of blatant misrepresentation of the empirical evidence and simplistic analysis that is incorrect and misleading.

- The FCC's own econometric analysis shows that satellite does not now, nor has it ever, exerted a significant and substantial competitive effect (cross-elasticity) on cable industry price, quantity or quality.

Contrary to the claims of the industry, satellite did not steal customers from cable. The majority of satellite subscribers came from markets where cable had not gone, or could not economically go – rural areas and high quality, high volume service. Satellite had a niche that did not threaten cable's core market. The dominant cable companies continue to have more than an 85 percent market share in the MVPD markets where intermodal competition exists.

However, cable is now attacking satellite's niche with its digital service and high-speed Internet access bundle of services. Satellite never threatened the huge core of the cable market, but cable is now threatening the satellite niche. Simply put, the intermodal competition between satellite and cable was never strong and it is getting weaker with the rollout of digital cable.

Pricing data also show that cable companies are not disciplined by the presence of satellite.

- Cable prices have been rising at almost three times the rate of inflation since the passage of the Telecommunications Act of 1996.

- The FCC data show that the cable operators most likely to face head-to-head competition from satellite – larger multiple system operators (MSOs) who have urban clusters charge higher, not lower prices.

- In the small number of communities that have been 'officially' declared competitive by the FCC because of the high level of satellite penetration, we also find cable prices are higher than elsewhere.

In the FCC analyses, the only form of competition that appears to work in the video market is head-to-head (intramodal) competition between cable companies. Unfortunately, it is virtually non-existent. Only about 1 percent of franchise territories have experienced overbuilder competition between cable companies.

Strategic Supply and Pricing of Advanced Services

The broadband Internet access market is dominated by a very small number of facility owners who have market power and incentives to discriminate against independent content providers. Almost half the nation has no choice between technologies.

- Cable dominates the residential high-speed Internet market, with a 65 percent market share for all "broadband" services. However, it has a 75 percent market share for the advanced services residential market.

- Digital Subscriber Line service (DSL), the telephone industry's high-speed offering, dominates the non-residential market with an 89 percent market share.

Using its market power in the high-speed Internet access market, cable has priced its service strategically, charging a low price for digital video tiers of service and a high price for cable modem service.

- Although the digital video tier and cable modem service are provisioned from the same technology upgrade and have similar incremental costs, cable operators have priced cable modem service at three to four times the level of digital video tiers.

- Cable also forces most consumers to give up their current Internet Service Provider to get cable modem service, or to pay an additional fee to keep that provider.

The commercial access that AT&T and Comcast are offering is nowhere near what is needed to preserve the competitive, consumer-friendly, innovation rich environment we have come to know and love on the Internet. The cable owner

- chooses a small number of ISPs who can sell a restrictive set of services;

- tells the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;

- controls the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and

- places independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content.

Cable operators have a strong incentive to retard innovation that might compete directly with their core video services, or even indirectly for consumer video entertainment attention. Restricting the number of service providers and the services they can provide ensures cable companies control the flow of innovations and takes away the incentive to develop new applications. This is the antithesis of how the Internet was created. In the narrowband Internet, intramodal competition at the level of content – ensuring that content providers and applications developers were given non-discriminatory access to facilities – was highly successful in stimulating entry and innovation.

The cable operators' closed networks are apparent in the statistics of high-speed Internet access providers. There are only 47 high-speed Internet service providers using cable modem service nationwide – essential the monopoly cable companies offering service on an exclusive basis in their franchise areas. This number has been virtually constant for past two years. There are almost three times as many high-speed Internet access service providers using other technologies, and this number has almost doubled in the past two years.

Conclusion

Intramodal competition at the level of facilities – direct competition between similar facilities – is more effective than intermodal competition, but it is virtually non-existent and many analysts now believe that telecommunications and MVPD markets will not support vigorous facility competition. They are likely, at best to be duopolies. This is simply too little competition to discipline abusive pricing and strategic manipulation of supply.

Intramodal competition in the form of promoting competition between service providers over bottleneck and essential facilities appears to work better, but has never been tried in the cable industry and has been inconsistently implemented for the telephone companies. Unfortunately, the myth of intermodal competition is being used to drive policy farther from approaches that have a reasonable chance of achieving substantial competition in both the digital video and high-Internet access markets.

The fiction of intermodal competition helped convince the courts to overturn structural limits on cable ownership aimed at the video market. The FCC invoked this myth to refuse to require nondiscriminatory access to the advanced telecommunications services provided by cable systems. The same fiction is the basis for the FCC's proposals to abandon the obligation to provide nondiscriminatory access to the advanced telecommunications facilities owned by telephone companies.

The inevitable result of basing policies on competitive fictions, rather than facts, will be escalating consumer harm – high prices, poor service and retarded innovation.

I. INTRODUCTION

CROSS TECHNOLOGY COMPETITION IS DRIVING MAJOR PUBLIC POLICY DECISIONS, BUT IT IS FAR WEAKER THAN THE CABLE INDUSTRY CLAIMS

The U.S. Court of Appeals for the D.C. Circuit recently overturned the Federal Communications Commission (FCC or the Commission) rule that prevents cable TV system operators (multiple system operators or MSOs) from owning broadcast TV stations in their own market. At a key point the Court points to the claim made by cable companies that "competition from direct broadcast satellite (DBS) providers makes discrimination against competing stations unprofitable."[1] The Court did not conclude that the cable companies are correct; rather, as in most of the decision, the Court chastised the FCC for failing to build an adequate evidentiary record to respond to the claim.[2]

Similarly, the FCC has invoked cross-technology competition in its proposals to deregulate high-speed Internet access services and allow incumbent local telephone companies to withhold access to their local facilities. Cable plays a central role in both of those proceedings

> The task set out by the statute – to implement a competition policy that provides incentive for the "deployment" of advanced telecommunications capability without regard to transmission technology – requires a special focus on questions of intermodal and intramodal competition as they relate to broadband technology…For example, how widely is upgraded cable plant deployed, and how much of it can support telephony, broadband or both applications?[3]

At the same time, in defending their merger, ATT/Comcast claim that "the merged company faces intense competition from DBS providers."[4] They cite their filings in the ongoing Horizontal Limits proceeding.[5] They also claim cross-technology competition in the high-speed Internet market, citing "the need to compete with DSL and other comparable offerings."[6]

Since these claims about competition between cable and competing technologies are playing a critical role in determining the ownership structure of the dominant distribution mechanism for both mass media and advanced telecommunications services, the behavior of this industry and the impact of intermodal competition deserve extremely close examination.

This paper demonstrates that cable industry claims about cross technology competition and FCC hopes that intermodal competition will discipline cable market power to provide an open, consumer-friendly communications environment cannot be supported by empirical evidence.

- Cable TV has not been disciplined by the presence of satellite in the past and is less likely to face stiff competition from satellite in the foreseeable future.

- Cable modem service currently dominates the residential broadband market and is not likely to be threatened by DSL or wireless broadband Internet access service in the foreseeable future.

- As a result, cable companies have a great deal of market power at the point of sale. This market power has impacts throughout the industry and its related markets.

The widely noted convergence of media and communications would be justification enough to consider digital video and high-speed Internet services together. However, we find very strong and specific technology and market behavior evidence that demands that the analysis of these two markets be joined.

Cable companies provide both services from the same platform. The upgrades necessary to provide the current generation of MVPD service also make the provision of high-speed Internet service available. The vast majority of the costs of the upgrade are common between the two. Cable companies have bundled the two services together, offering a substantial discount for the package of the two services. Cable's market power in the MVPD market is being leveraged and extended into the high-speed Internet market and we show that cable is strategically pricing and managing the rollout of the two services.

OUTLINE OF THE PAPER

The remainder of this paper is divided into three chapters.

Chapter II deals with the multichannel video programming distribution market (MVPD). It demonstrates that cable industry claims about competition at the point-of-sale presented to the Commission are a mixture of blatant misrepresentation of the empirical evidence and simplistic analysis that is incorrect and misleading. After demonstrating the lack of competition with elasticities of demand and substitution and patterns of expansion in the market, the paper provides a realistic map of the multichannel video product space. It draws on the results of an extensive survey of attitudes of cable and satellite consumers.

Chapter III deals with the cable modem service in the broadband Internet access market. It shows that advanced telecommunications markets are dominated by a very small number of facility owners who have the market power and incentive to foreclose and discriminate against independent content providers. It then examines the cable industry's strategic pricing and supply of high-speed Internet access service.

With a firm grounding in empirical reality, Chapter IV of this paper turns to a discussion of the public policy issues in formal economic terms. It presents measures of market structure and market power from the study of industrial organization that have been applied to cable industry. It shows that at the point-of-sale the MVPD market, the broadband Internet market and the narrowband facility Internet access market are highly concentrated. Using several different measures of market power, it shows that the cable industry possess market power.

II. FICTION IN CABLE-SATELLITE COMPETITION

COMPETITION AT THE POINT-OF-SALE IS WEAK, AT BEST

The Central Importance of Competition at the Point-of-Sale

The centrality of competition at the point-of-sale to the analysis of the cable industry is demonstrated in the Horizontal Limits Proceeding by the inability of cable industry experts to articulate their arguments against the horizontal rule without invoking head-to-head competition as the driving force in the industry. The expert witness for AT&T claims that "stiff competition"[7] from a close substitute[8] denies the industry market power because of " the demonstrated ability and willingness of consumers to switch between cable-based and direct broadcast satellite ("DBS")-based multi-video programming distribution ("MVPD").[9] The witness for AT&T provides a series of observations that make it clear how central this issue is to the policy decision:

> First, exercise of buyer market power requires a *credible* threat to withhold carriage if the supplier refuses to accede to the buyer's anticompetitive demands. Here, however, programming suppliers know that in the presence of DBS (and other cable competitors such as overbuilders and MMDS providers), inefficient purchasing decisions by a cable operator – *i.e.*, refusals to carry competitively priced programming that subscribers demand – would impose substantial costs on the cable operator in the form of (existing and future) subscribers lost to rivals… the willingness of customers to choose DBS over cable is highly relevant to the programming supplier's own assessment of its available alternatives.[10]
>
> Any attempt by a cable MSO to degrade the quality of its programming in order to foreclose a rival would cause it to lose significant customers to DBS and other alternatives thereby undermining the effectiveness of its strategy. [11]

Similarly, at the core of the discussion offered by Gregory Rosston and Howard Shelanski experts for the National Cable Television Association, is the claim that "If a cable operator were to exercise monopsony in such a manner, it would lose customers to DBS rivals who can purchase more, and higher quality, programming and thereby take market share from cable."[12]

Misrepresentation of the Econometric Evidence by Cable Experts

If satellite were a close substitute for cable, one would expect that it would have a large effect on cable. In fact, the FCC's own findings and data have contradicted the cable industry claims for years. The Commission never stated that cable and satellite are close substitutes. It found that satellite only "**exerts a small (shown by the small magnitude of DBS coefficient) but statistically significant influence on the demand for cable service."**[13] Even the finding of a small effect has recently been reversed.

In the same econometric estimation, the Commission concluded that the **"the demand for cable service is somewhat price elastic (i.e. has a price elasticity of minus 1.45) and suggests that there are substitutes for cable."**[14] This elasticity is not very large and the Commission recognizes that in using the adjective "somewhat."

The FCC also attempted to estimate a price effect between satellite and cable. If cable and satellite were close substitutes providing stiff competition, one would also expect to see a price effect. Most discussions of in economics texts state that substitutes exhibit a positive cross-price elasticity.[15] The FCC can find none. In fact, it found quite the opposite. The higher the penetration of satellite, the higher the price of cable.[16]

The other piece of empirical evidence the cable company rely on to demonstrate cable-satellite competition is even more damning. The expert witness for AT&T claims that a study by Goolsbee and Petrin[17] indicates that cable and satellite are close substitutes.[18]

> Likewise, in a recent paper, Professors Goolsbee and Petrin… estimate a system of demand curves for over-the-air TV, DBS, expanded basic cable services and expanded basic and premium cable services… From their estimated elasticities and shares, one can compute diversion ratios, which are a measure of substitutability between goods… These diversion ratios are significant and imply that **DBS and basic cable are close substitutes.**[19]

In fact, Goolsbee's and Petrin's conclusion is quite the opposite.

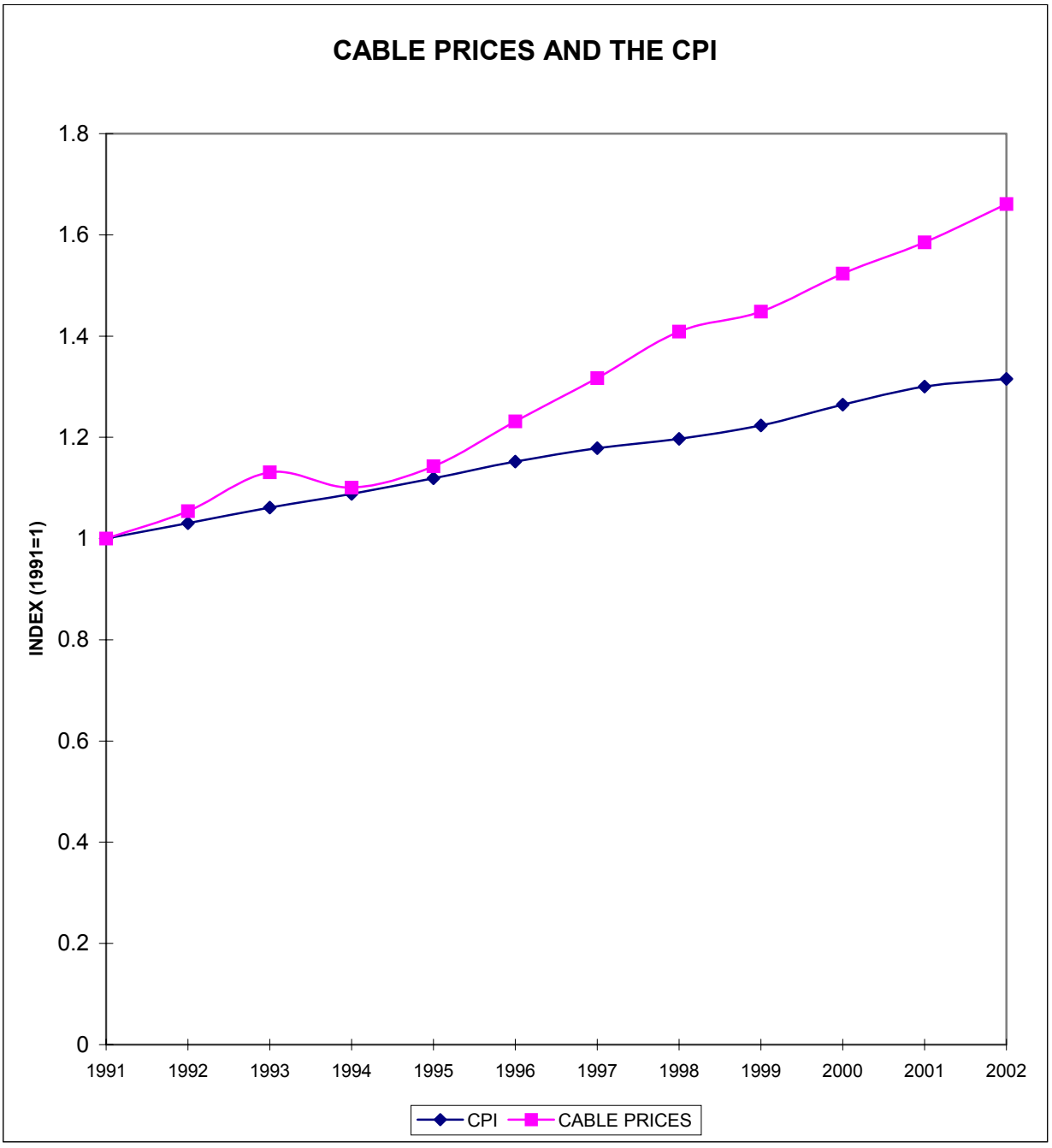
> The demand for cable is rather insensitive to its own price and to the DBS price. Premium cable is more price responsive than basic is, though neither is particularly elastic… In other words, the demand estimates indicate that **DBS is not a particularly good substitute for cable in the minds of consumers.**[20]

This is no simple oversight. The Goolsbee and Petrin study actually starts by citing the complaints of consumer groups that prices were being deregulated without adequate market forces to discipline them. It set out to study DBS and found it wanting as a competitor (see Exhibit 1).

> The Telecommunications Act of 1996, however, phased out most price regulation and instead tried to promote competition as a check on price. The explicit goal of the Act was to stimulate local phone companies or new cable start-ups to enter the market.
>
> As a general matter, this effort to encourage entry failed. Phone company and new cable entrants have been rare. Consumer advocates say that unfettered monopolies can now raise prices with impunity (Consumer Federation of America, (2001)). As the CPI and the Cable Television CPI data… indicate, since the phase out of price regulation began in 1996, the prices of cable have grown about 2.5 times faster than overall prices in the economy. This has led to increasing public calls for congress and the FCC to re-regulate cable, at least until there is "viable competition" (Kimmelman (1998)).[21]

The study found a lower elasticity of demand than the Commission and noted that the cable operators moved aggressively to increase prices, upon deregulation. Their behavior was consistent with the exercise of market power.

EXHIBIT 1:



Source: Austan Goolsbee and Amil Petrin, *The Consumer Gains from Direct Broadcast Competition with Cable TV* (May 29, 2001) (extended through January 2002).

> Using the baseline specification, the results indicate that to get to the point where the elasticity of demand reached –1 (the minimum price increase compatible with static profit maximizing), the firms would need to raise prices by 17%. To give some perspective, in the period immediately following our sample, prices actually rose by about 11%. [22]

This misstatement of facts has a devastating impact on the cable industry arguments. Without point-of-sale competition, cable operators do not face market discipline in their programming choices. They can raise prices, scrimp on quality to enrich themselves, degrade the programming bundle by discriminating against non-affiliated programs, or use monopoly rents to further the political agenda of the system owners, without suffering significant economic loss.

More Recent Data Thoroughly Contradicts the Cable Industry Claims and FCC Theories About Intermodal Competition

The most recent annual report on cable prices shows that the presence of DBS has no statistically significant or substantial effect on cable prices, penetration or quality.[23] This is true when measured as the level of penetration of satellite across all cable systems, or when isolating only areas where satellite has achieved a relatively high penetration.[24]

At the same time, ownership of multiple systems by a single entity, large size and clustering of cable systems results in higher prices.[25] Vertical integration with programming results in fewer channels being offered (which restricts competition for affiliated programs).[26]

In other words, one could not image a more negative finding for intermodal competition from the FCC's own data. All of the concerns expressed about concentrated, vertically integrated distribution networks are observed and the presence of intermodal competition has little or no power to correct these problems. All of the claims that the cable industry makes about the benefits of clustering and large size are contradicted by the data.

In fact, only intramodal, head-to-head competition appears to have the expected effects. The presence of wireline competitors lowers price and increases the quality of service. Unfortunately, as discussed below, intramodal competition is virtually non-existent in the industry.

SUBSCRIBER PATTERNS CONTRADICT CABLE INDUSTRY CLAIMS AND SUPPORT THE VIEW THAT THERE IS LIMITED COMPETITION BETWEEN SATELLITE AND CABLE

Satellite's Initial Success Came in Entering New, Niche Markets, It Did Not Compete for Cable's Existing Markets

With feeble support for the claim of competition in the econometric evidence, it is not surprising that cable industry analyses are forced to misinterpret subscriber patterns to maintain a consistent story. Ordover states "the non-cable share of the MVPD business continues to experience an annual growth rate of nearly 20%. Most of this growth has come from luring away existing cable subscribers."[27] Rosston and Shelanski state that "Since cable had virtually 100% market share of MVPD customers in 1994, the gains for the DBS providers has come at the expense of cable."[28] This simplistic analysis is wrong and does not stand close scrutiny (see Exhibit 2).

Cable's subscriber base is growing and has continued to grow at a steady pace throughout the recent period of rapid satellite growth. Without careful analysis, cable industry experts incorrectly assume the growth of satellite has come entirely at the expense of cable. The cable industry experts have ignored new markets. The industry and the FCC have confused separate geographic markets and product market segments served by different technologies with intermodal competition.

In fact, satellite drew its subscribers from two places that cable had not gone. As discussed below, a very substantial segment of the satellite market exists in places not served by cable. Moreover, satellite was the only digital service available for a considerable period of time. In other words, cable was not losing subscribers to satellite, satellite was expanding the market and there is no reason to believe that, during this time period, cable could have entered those markets with an economically attractive offering. Because a very substantial part of satellite growth did not "come at the expense of cable," it did not discipline the market behavior of cable.

The implications of this analysis for public policy are important and straightforward. Satellite has always been a digital niche player. It never competed for the bulk of cable's basic/expanded basic customer base. J.P. Morgan has recently offered exactly this view of the cable-satellite product space.

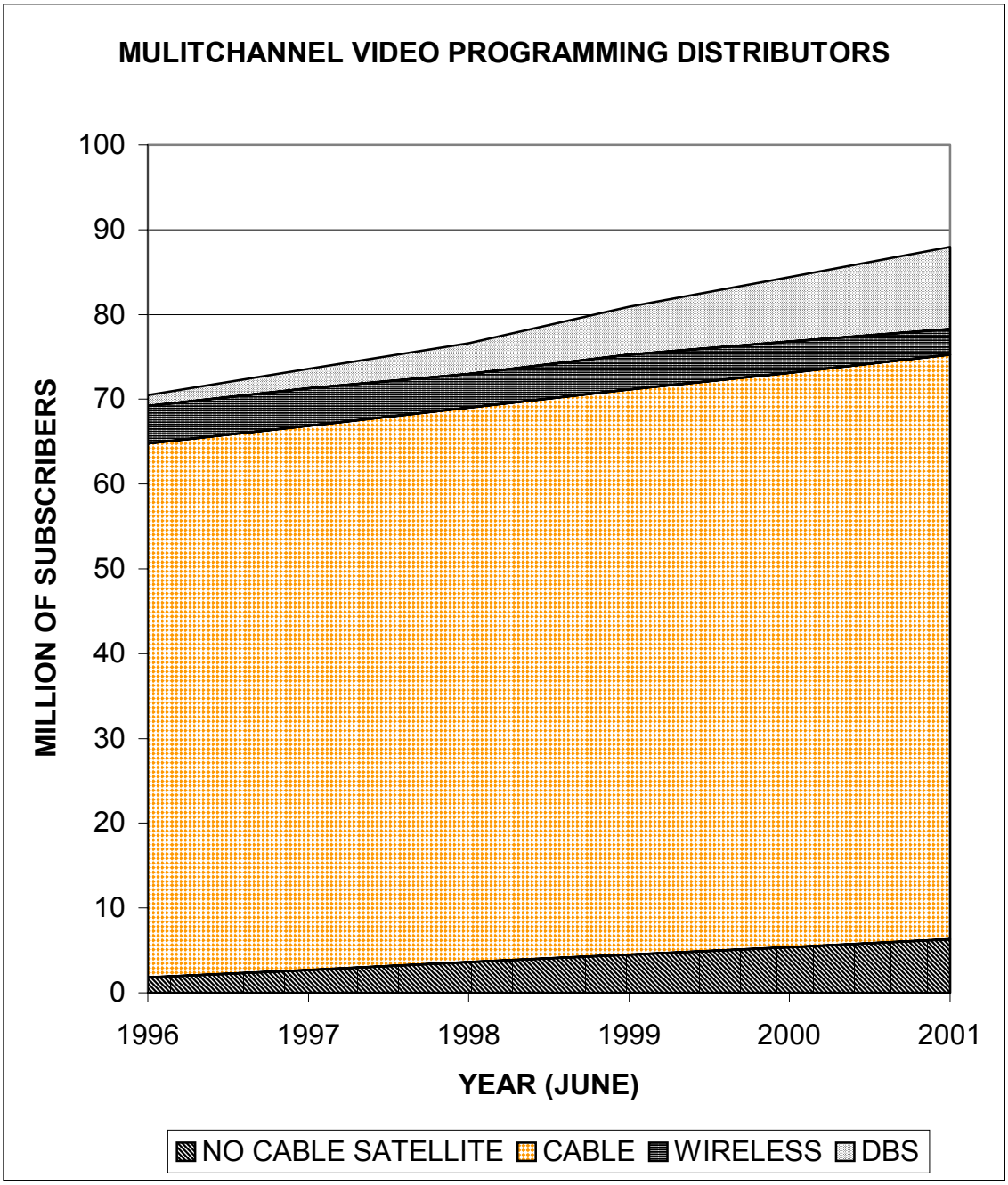
> We believe that more than 95% of all cable churn is caused by factors other than DBS competition. Competition generated churn rates of just 1.3% per year during the past five years, suggesting that former cable customers make up less than one-third of DBS's current customer base. The implication of this finding is significant because it suggests that the vast preponderance of DBS's growth depended on first-time multi-channel video (MVC) subscribers. We believe that growth in the MVC market will drop off in the next several years as the potential population of first-time MVC subscribers dwindles.[29]

Prospects for Future Competition Between Cable and Satellite are not Encouraging

Failing to make a careful analysis of subscriber patterns, cable commenters incorrectly project large continuing gains for satellite.[30] The projections are highly suspect.

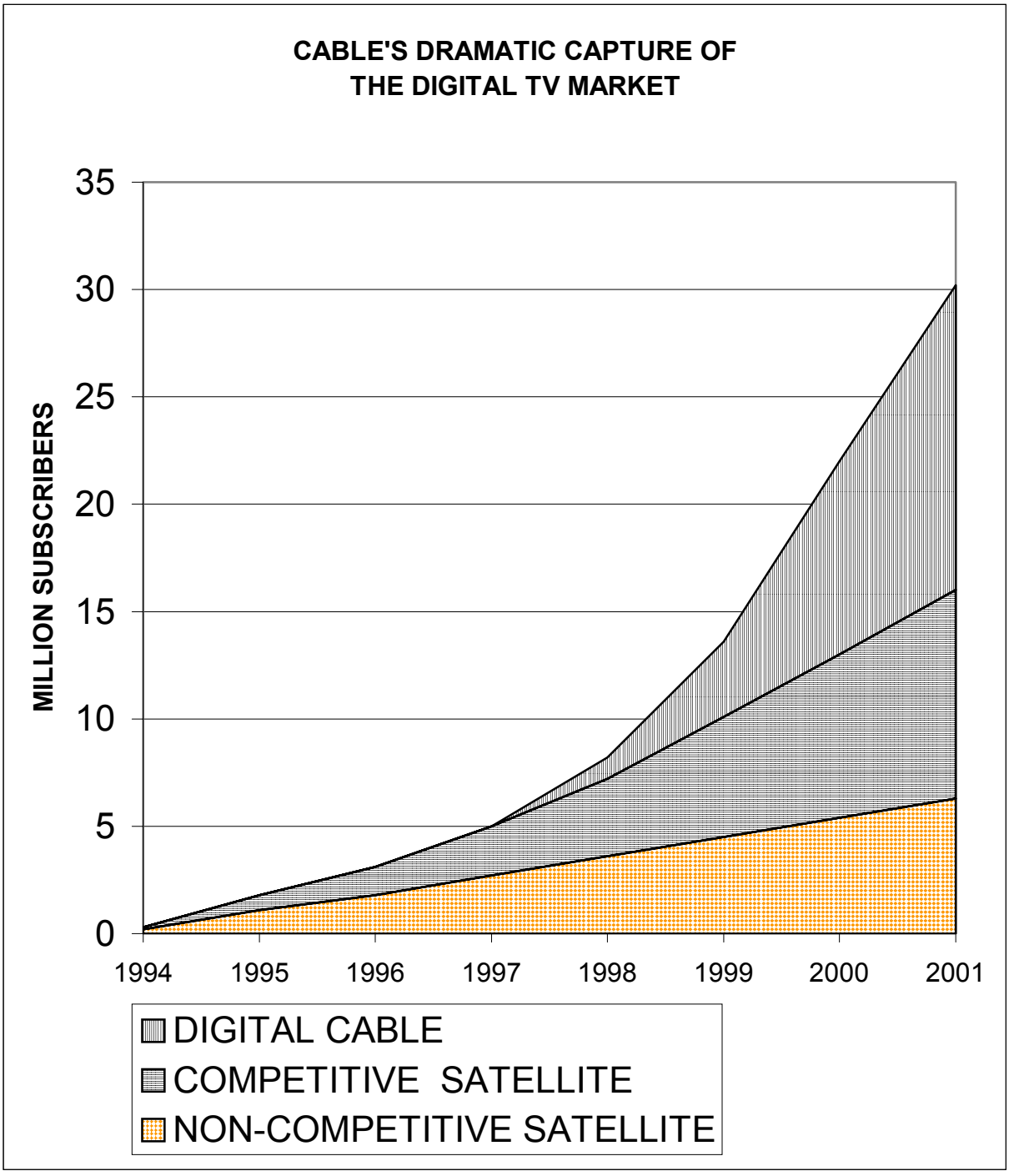
Exhibit 3 shows the pattern of growth of digital subscribers in markets where cable and satellite actually compete. Cable's offering is growing much faster than satellite's comparable service. Therefore, the cable industry's projection of past trends to try to project vigorous future competition between satellite and cable is undercut. The addition of high-capacity digital cable and cable modem Internet services allows cable operators to attack the high-end niche that satellite occupies.[31] Cable will be able to leapfrog satellite at the high-end of the market, particularly when it is bundled with high-speed Internet access.

EXHIBIT 2



Source: Federal Communications Commission, Eighth *Annual Report*, In the Matter of Annual Assessment of the Status of the Market for Delivery of Video Programming, January 14, 2002.

EXHIBIT 3:



Source: Federal Communications Commission, Eighth *Annual Report*, In the Matter of Annual Assessment of the Status of the Market for Delivery of Video Programming, January 14, 2002. Jason B. Bazinet, *The Cable Industry* (J.P. Morgan Securities, Inc., November 2, 2001),

The fact that cable now has an offering to compete in the satellite niche will slow satellite penetration. Cable has other advantages as well.

> The outlook for DBS is all the more ominous when we look at total digital net adds across both cable and DBS. Since cable began offering a digital video service, it has increasingly shown its ability to capture a larger portion of net adds in each successive quarter. In large part, we think this reflects the simple reality that cable must merely convert existing customers from analog while DBS must acquire a new customer, a far costlier and perhaps untenable proposition in the long run. Cable's simple structural advantage will likely be difficult for DBS to overcome.[32]

The J.P. Morgan analysis shows that satellite digital additions peaked in late 1999 and early 2000. Morgan Stanley Dean Witter had earlier predicted this pattern when it state that "we also believe that DBS additions will peak in 2000 as the cable television industry completes the majority of its system upgrades and deploys digital cable service throughout the U.S."[33]

As a result, cable is in a much stronger position than satellite. JP Morgan analysis concluded that "[with the multi-channel video market approaching saturation and cable now capturing more than 70% of digital net adds against DBS, the satellite threat is significantly diminished."[34] Similarly, Merrill Lynch projects that digital cable growth will "slow" to about a 30 percent growth rate next year, still at least 50 percent more than satellite.[35]

Recognizing saturation, a lack of competition, and market segmentation, shows satellite to be a niche player that is more likely to lose customers to cable over the next few years than win customers from cable. Simply put, competition was never strong and it is getting weaker with the rollout of digital cable.

> Although we think the competitive overlap between DBS and cable is low, a historical analysis of DBS net adds relative to digital cable net adds suggests
>
> cable is rapidly closing in on DBS. In 1999, both digital cable and DBS were adding subscribers at roughly the same rate, but now digital cable is rapidly closing the gap. Presumably it is less expensive to upgrade an existing cable customer than it is for a DBS player to sign up a brand new customer.[36]

SURVEY RESULTS SHOW THAT CABLE- SATELLITE COMPETITIVE OVERLAP IS SMALL

The previous section demonstrated the inability of satellite to discipline cable with quantitative data on pricing and product substitution. As suggested above, this data "indicate that DBS is not a particularly good substitute for cable in the minds of consumers." This section examines survey data to gain another perspective what is going on 'in the minds of consumers." Recognizing geographic and product market differences we reinforce the conclusion that "the competitive overlap between DBS and cable is low."

Geographic Markets

These observations are based on patterns that are readily identifiable in a number of data sets. For example, Centris, which does weekly surveying of multichannel video households, recently estimated that 40 percent of satellite subscribers live in areas where cable is

unavailable. Approximately 41 percent of the respondents to the Consumers Union Survey who have satellite report that they do not have access to cable. In filings at the FCC, DirecTV states that its subscriber base was half urban and half rural.[37] In the recent past, however, it claims that about two thirds of new subscribers have been from urban areas. Given that over three-quarters of the U.S. population lives in urban areas, satellite subscribers are still disproportionately rural.

A second group of customers represents a geographic market problem for satellite. This is made up of 2 to 2.5 million people who take both satellite and cable.[38] For these customers, cable and satellite would appear to be complements rather than substitutes. One reason to take both services is that local programming is more limited from satellite.

Satellite subscribers who also take cable have a lower cable bill than other cable subscribers. They are almost three times as likely to report that their cable bill is less than $30 per month (46 percent to 17 percent), suggesting that they take the basic tier which gives them the local channels they cannot get with satellite. They also report watching many fewer channels than other satellite subscribers and cable subscribers.

Satellite may overcome this handicap in some markets, depending on available capacity to transmit local channels. However, with the advent of digital cable, as the JP Morgan analysis suggests, it is unlikely that this will be a large source of future growth for satellite.

Thus, in this survey, just over half of respondents either cannot get cable or appear to view it as a complement for cable, rather than a substitute because they want local stations. Just under half of the respondents have a choice between satellite and cable and choose satellite over cable. They are the focal point of the remainder of the analysis.

Product Markets: Satellite Fills a High Volume/High Quality Service Niche

This section analyzes the responses of satellite subscribers who have both cable and satellite available. The subset of consumers who take satellite only does so because it is perceived as a high volume, higher quality service. The most frequent reason given is the large number of channels (see Exhibit 4). The large number of channels attracts three-quarters of the competitive market, satellite-only subscribers and 40 percent cite dissatisfaction with cable channel selection. A majority also says cable costs too much. Since, as we will show, cable is less expensive than satellite, this may seem odd, but looking at the value proposition of satellite and cable solves the puzzle.

A direct question posed to consumers on their perception of the value of satellite and cable knits these responses together (see Exhibit 5). Respondents were asked, “Overall, how good a value (in terms of programming choices and quality) do you consider this system to be, given the costs?” Satellite fared better.

EXHIBIT 4: REASONS FOR SUBSCRIBING TO SATELLITE SERVICES:
(Percent of Respondents, Multiple Responses Allowed)

SATELLITE POSITIVES	Only Satellite
n =	597
Wider selection	
Lg. # of Channels	75%
Sports selection	26
Pay-per-view selection	24
Audio selection	21
Higher Quality Sound & Pictures	31
CABLE NEGATIVES [b/]	
Cost too much	51
Poor selection of channels	40

Source: Consumers Union Survey

EXHIBIT 5: VALUE PROPOSITIONS FOR SATELLITE

	Satellite only	All cable
n =	487	646
Excellent	35	6
Good	59	63
Poor	7	31
TOTAL	100	100

VALUE PROPOSITIONS FOR CABLE AND WILLINGNESS TO SWITCH

		Willing to switch	Not willing to switch	Total
n =		95	460	
Excellent		0	100	100
Good		12	88	100
Poor		31	69	100
TOTAL	17	83	100	

Source: Consumers Union Survey

Overall, satellite subscribers are much more favorable about the value proposition than cable subscribers. Although for both services the most frequent response was 'good value,' for satellite there was a much larger group of subscribers who see their value as excellent than for cable (30 percent v. 6 percent). In contrast, for cable there was a much larger group who see their service as a poor value than satellite (31 percent v. 8 percent).

However, dissatisfaction with the cable value proposition does not always translate into a decision to subscribe to satellite. Only 17 percent of the cable respondents said they would consider switching to satellite. Those who are willing to switch are much more likely to have expressed dissatisfaction with the cable value proposition. Nevertheless, less than one-third of those who said cable is a poor value are willing to switch.

Another recent survey of satellite and cable customers reinforces these findings.[39] It found a much higher level of satisfaction with satellite pricing than with cable pricing. The value proposition question, worded somewhat differently, found lower levels of satisfaction for both. While a substantial majority was satisfied with the value proposition of satellite (64 percent satisfied v. 36 percent dissatisfied), a majority of the cable respondents were dissatisfied (44 percent satisfied v. 56 percent dissatisfied). Specific complaints about cable parallel the earlier findings. Respondents were much more likely to complain about cable price increases (60% v. 24%), lack of channels (approximately 30% v. 14%), and dropping channels (approximately 25% v. less than 15%).

Cable and Satellite Subscribers Consumers Exhibit Sharply Different Consumption Patterns

Given the attraction of satellite's wide selection, we should not be surprised to find that satellite owners have very different viewing patterns than analog cable subscribers (Exhibit 6). In the table the arrows highlight the relevant differences.

Competitive markets, satellite-only subscribers are less likely to watch broadcast networks and local public access channels (which they probably cannot get). Even the satellite subscribers who also get cable are less likely to watch local public access channels. Competitive market, satellite-only subscribers are more likely to watch premium movie, sports and pay per view channels than those who get cable and satellite or just analog. However, digital cable subscribers look more like satellite-only subscribers than analog cable subscribers in their purchases of premium movies, sports and pay-per view.

Examination of the data reveals that the cable analog group has a clearly identified subgroup that we call the "lunch bucket," cable group. Eighty percent of the cable analog group subscribes to only basic and expanded basic service and takes no additional tiers. This represents the largest segment of cable subscribers by far, with 42 million. The remainder of the analog cable group is more upscale, subscribing to, on average, a total of 4 tiers.

EXHIBIT 6:
VIEWING PATTERNS
(Percent of Respondents)

	SATELLITE ONLY			SATELLITE + CABLE			CABLE ANALOG			CABLE DIGITAL		
	N	O	D	N	O	D	N	O	D	N	O	D
PROGRAM TYPE												
Broadcast Networks	30	26	45	4	26	70	1	4	75	2	22	76
Local Pub. Access	68	23	9	48	38	14	29	62	9	32	52	10
Std. Cable/ Sat Channels	5	48	47	25	39	36	3	61	36	4	58	38
Premium Movie	37	34	30	78	15	7	73	22	5	38	34	28
Premium Sports	67	27	7	86	9	5	81	16	3	59	29	12
Pay-per-View	48	51	2	89	11	0	95	5	1	71	21	2

Notes
N = Not at all; O = Once a month to a few times a week; D= Daily or almost daily.
* = Sample sizes vary across the comparisons but to nonresponses. Cell sizes and statistical tests are available upon request.

Source: Consumers Union Survey

BILLS AND PRICING

Given the strong preference for quality and different viewing patterns, we should not be surprised to find difference in pricing and bills between the two services. The issue of whether satellite is more expensive than cable is always confounded by differences in quality. Satellite is a different product.

Satellite Bills are Higher

Satellite tends to deliver more channels. It has higher front-end costs. Just over two-thirds of the respondents paid for their satellite system and the median cost was $200. Over half paid for installation, and the median was $75. In contrast, over four-fifths of cable subscribers paid less than $25 for installation. Pricing has varied historically. When we looked at costs we looked at the last year only. Cable costs have been increasing and satellite costs have been declining. Nevertheless, even renting the satellite equipment, which has become an option, adds to the cost.

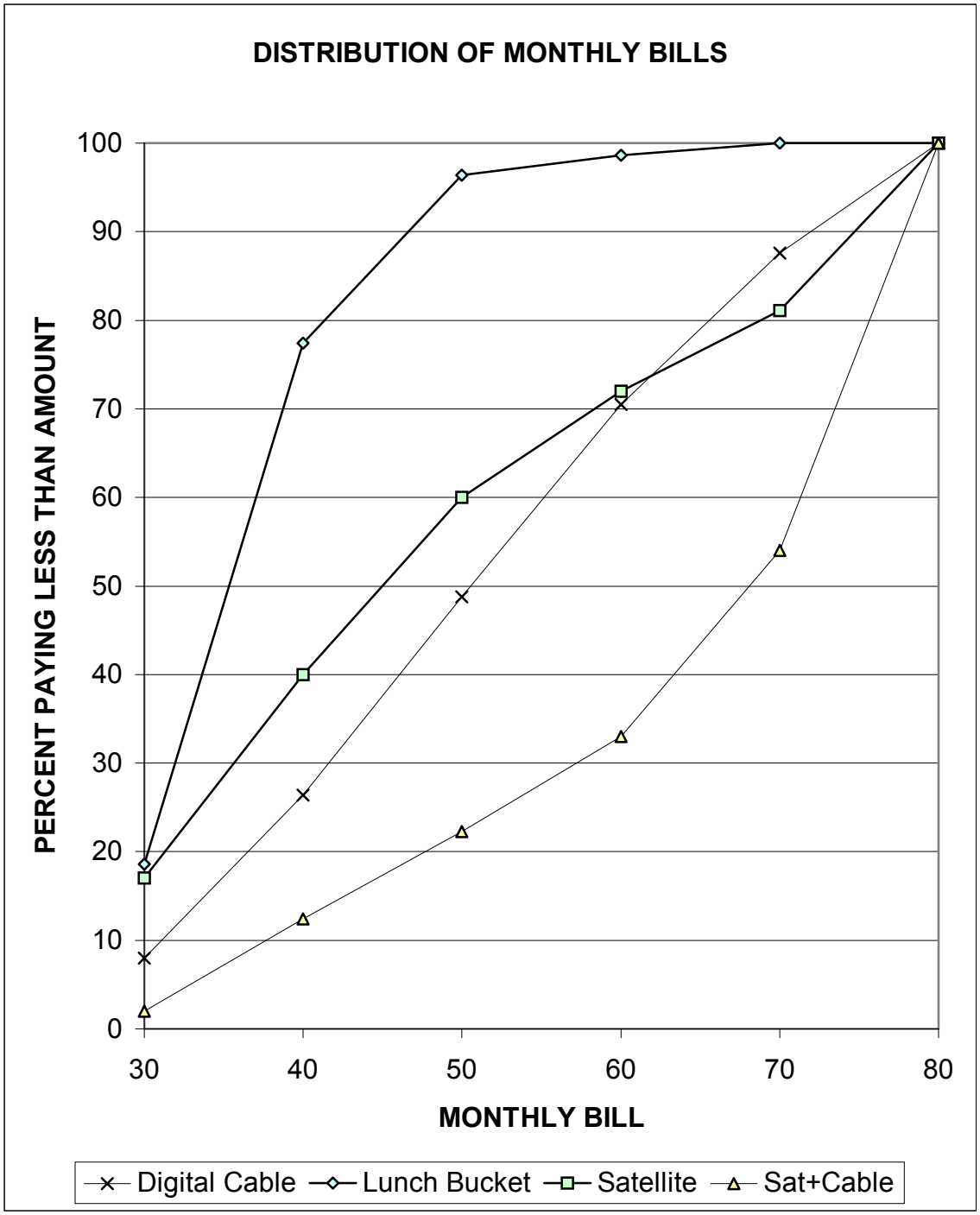
Monthly charges exhibit different patterns, particularly when the market segments are considered. Exhibit 7 compares the "lunch bucket" cable group (analog no additional tiers) to the satellite- only group in areas where cable is available as well as digital cable and satellite plus cable. There are very few satellite subscribers who take a small package of services similar to this group of cable subscribers.

Taking this view, the lunch bucket cable group reports a substantially lower bill (median of $36) with the distribution skewed to the low end (95 percent spend less than $50). At the other extreme are those who take cable and satellite. They have a median bill of $68, with the distribution skewed to the high end (almost 80 percent spend more than $50). Digital cable and satellite subscribers fall between the two extremes, both with a median bill of about $50 and an even distribution of bills.

Cable Pricing Patterns Indicate the Abuse of Cable Market Power

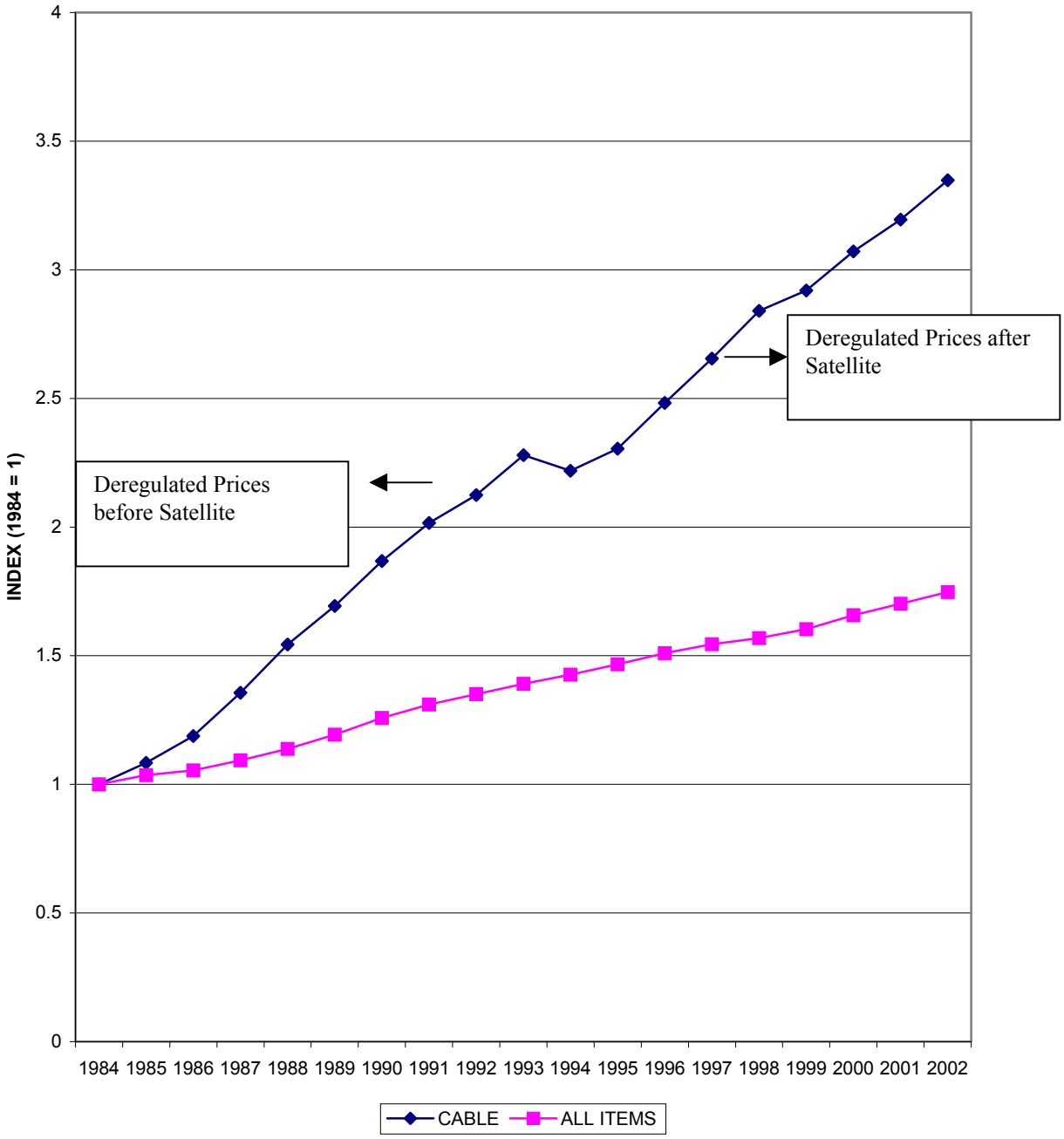
Despite all of the talk about changes in technology and more aggressive efforts to stimulate competition in the 1996 Telecommunications Act, rate increases during the period since its passage have been similar to increases in the period after the passage of the 1984 Act, when rates were partially, then fully, deregulated. In fact, rates increases resumed their earlier deregulated pattern of relentlessly rising at two to three times the rate of inflation (see Exhibit 8).

EXHIBIT 7:



Source: Consumers Union Survey

EXHIBIT 8: LONG-TERM TRENDS OF CABLE PRICING



Source: U.S. Bureau of Labor Statistics, *Consumer Price Index*

> Not only have prices increased, but the industry has also restructured its revenue stream to maximize the leverage afforded by its market power. It has engaged in bundling, price discrimination, and other anti-consumer behavior (including activities such as efforts to impose negative check-offs and tie-in sales), driving consumers to buy bigger and bigger packages of programs at higher prices. While basic packages were being expanded and bundled to force consumers to pay higher prices, rates for pay services were flat. With consumers forced to buy more and more programs, the industry has increased its advertising revenues even more sharply than its other sources of revenue (see Exhibit 9).[40]

This is a prime illustration of the theory of extraction of consumer surplus that can be found in the economic and marketing literatures.[41] The key point here is that the ability to add programming to the expanded basic package allows the cable operator to charge more for expanded basic service than it is worth. Even where over-the-air signal might be competitive, this bundling gives cable operators the opportunity to exercise market power. People pay for something they apparently could get for free because they are actually buying something else--access to the multiple channels.[42]

It is clear that pricing/packaging in this way is intended to force consumers to take the package. In economic terms it transforms consumer surplus into producer surplus. Although consumers would be less willing to pay for certain elements of the larger cable programming package, they must swallow the whole thing because their access to the desired elements is tied to those they do not want. The companies never offer channels on an *a la carte* basis to determine if consumer demand exists. Consumers are forced to pay for the added, low value channels because they do not want to give up the whole bundle. Since there is no competition, there is no real alternative.

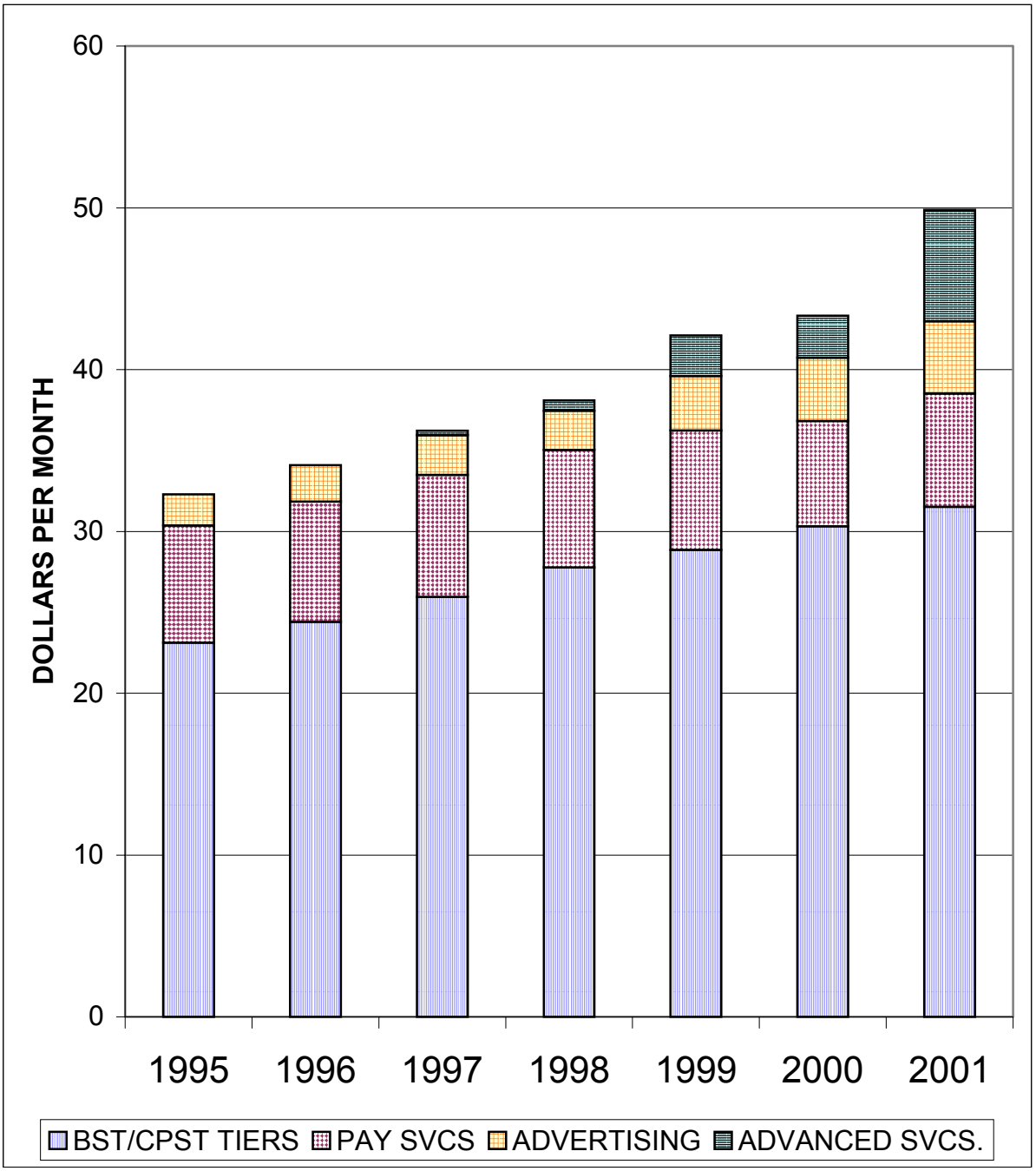
The cable strategy for responding to satellite is to exploit market power in the lunch bucket segment by driving up prices much faster than inflation. Viewers with less expensive tiers of cable programming are insensitive to rate increases because DBS only competes with cable for multiple pay-service tier subscribers (those who buy expensive sports and movie packages). Furthermore, cable MSOs are able to extract monopoly rents from the lower tier subscribers to cross-subsidize their competition with DBS for mega-service subscribers.

It makes better economic sense for cable operators to increase prices than to hold them down. Cable makes much more money by increasing prices for basic cable than competing in the DBS niche. The revenue gained by increasing cable prices to existing subscribers since the Telecom Act of 1996 exceeds the revenue lost to all DBS-only subscribers by almost 2-to-1 and all DBS-only subscribers in areas where cable is available by 3-to-1. Cable revenues added from new subscribers, at the higher prices, just about equaled cable revenues lost to new DBS-only subscribers in areas where cable is available.[43]

THE CABLE-SATELLITE PRODUCT SPACE

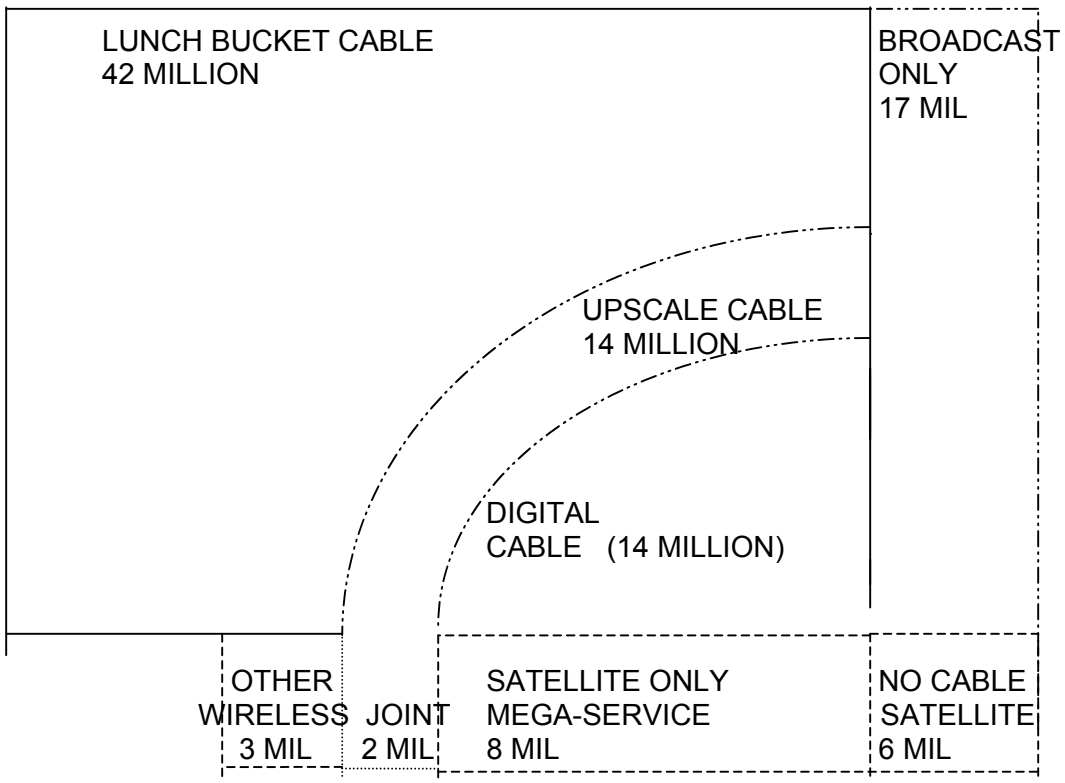
Combining the previous analyses, we can draw a clear map of the cable-satellite product space (see Exhibit 10).

EXHIBIT 9: CABLE INDUSTRY SOURCES OF REVENUE



Source: Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fifth Annual Report, December 23, 1998, Appendix B, and Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Eight Annual Report, January 14, 2002, Appendix B.

EXHIBIT 10:
THE MULTICHANNEL VIDEO DISTRIBUTION PRODUCT SPACE



Source: See text.

We identify three types of satellite subscribers.

- No Cable – Satellite. These respondents have satellite and cannot get cable. They represent about 6 million subscribers.

- Satellite Only – Mega Service: These respondents have satellite and can get cable, but choose to take satellite only. They are about eight million subscribers.

- Joint (satellite+cable): These respondents have satellite and cable. They are about 2 million subscribers.

We also identify three types of cable subscribers.

- Digital Cable: These respondents take the digital cable tier. They are about 14 million subscribers.

- Analog cable subscribers who total about (56 million) are divided into two subgroups.

    - Lunch Bucket (basic) Cable: After examining viewing patterns and bills, we identify a group of cable subscribers we call the "lunch bucket crowd," who take only the basic and expanded basic tiers of service. They are about 42 million subscribers.

    - Upscale cable subscribers, who take several additional tiers of service, but remain on analog. They are about 14 million subscribers.

There are still about 17 million households that receive TV over the air. We do not analyze these households in this discussion. As the JP Morgan analysis suggests, they are not likely to be a significant source of growth for cable or satellite in the near future. Several million are simply not served by cable or satellite and many in this group are lower income households unable to afford either.

Of the eighty million multichannel video subscribers who live in areas where cable and satellite are both available, only about 10 percent have chosen satellite over cable. These subscribers have preferences and viewing patterns that are quite distinct from the typical "lunch bucket" cable subscribers, who make up over half the 80 million households where both cable and satellite are available.

The satellite subscribers are, however, similar to digital cable subscribers. The number of subscribers to digital cable now almost equals the total number of satellite subscribers and it has been growing about twice as fast, especially in areas where both cable and satellite are available. Digital cable is a new technology development that hems in satellite as a competing product. This product offering puts a collar around satellite (some might say a noose), which will further diminish its competitive impact.

The failure of satellite to discipline pricing should come as no surprise. Even in the midst of the debate over delivery of local stations by satellite, the largest satellite provider eschewed price competition for the basic package.[44] The same was true on the cable side, where "anecdotal evidence shows that he response by large cable operators to increased DBS

competition often includes the offering of new services such as digital tiers and Internet access, rather than by lowering monthly charges." [45]

We have shown that cable operators have a secure base of monopolized customers (i.e. a market share far in excess of the traditional standard for monopoly). With this secure base of customers to exploit, cable now has developed a strategy to attack the mega-service niche of satellite – its digital tier and bundled video high speed Internet package. The weak market forces observed in the recent past are likely to get weaker.

III. STRATEGIC SUPPLY AND PRICING OF ADVANCED SERVICES

The confusion between geographic and product market extension and head-to-head intermodal competition that plagues the debate over video policy occurs in the high-speed Internet access area as well (see Exhibit 11). Cable dominates the residential high-speed Internet market, particularly the advanced services residential market, with a 75 percent market share. Digital Subscriber Line service (DSL), the telephone industry's high-speed offering, dominates the non-residential market, with an 89 percent market share.

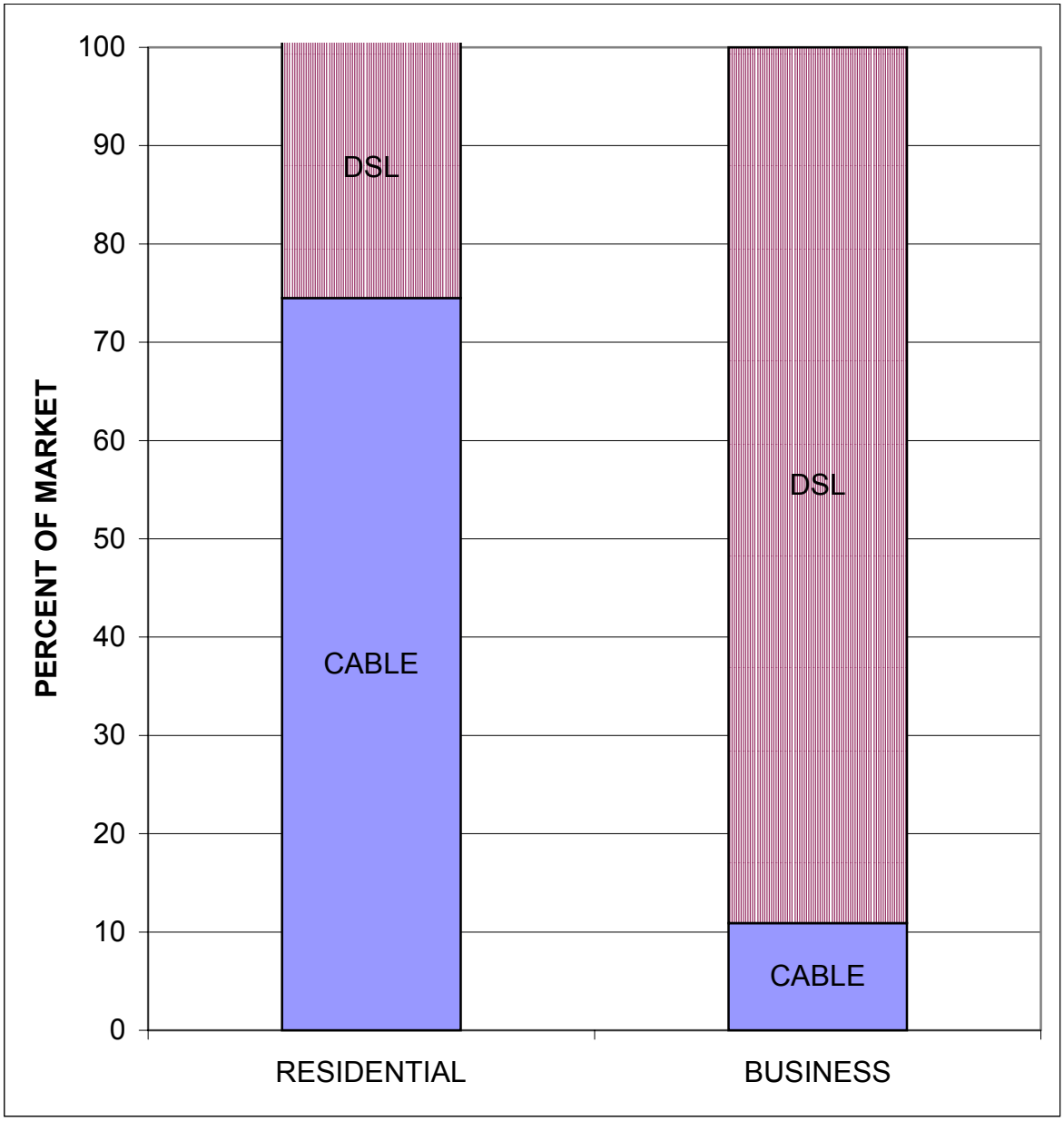
The JP Morgan report discussed in the previous section estimates that as these two service do not compete head-to-head in as much as half of the country today.[46] The recent by the Computer Science and Telecommunications Board of the National Research Council paints a picture of facilities-based competition that is not very encouraging.

> At least in more densely populated, more affluent areas, facilities-based competition appears to be possible. That is not to say that sustaining facilities-based competition will be easy…
>
> While there boundaries are difficult to forecast and will likely change over time, it is reasonable to anticipate areas where there is a single terrestrial provider.[47]
>
> It is a yet-unanswered but critical empirical question whether broadband local access will turn out to be a natural monopoly (as telephony was assumed to be for many years) in some or all markets. If so, it may continue to be dominated by the incumbent telephone companies and cable system operators, limiting facilities-based competition to at best two players. The fact that facilities-based competition has proved difficult to establish in the voice telephony markets that were the primary focus of the 1996 act, especially for residential service, is not encouraging, but there are difference between entry into a mature, saturated market and a new, evolving one.[48]

Commentators from academia, Wall Street and the popular press have noted troubling signs in the high-speed Internet access market in which limited competition leads to rising prices, crummy service and a lack of innovation.[49]

The central role of cable in the debate over broadband is well deserved. Cable companies are managing the transition from analog to digital in multichannel video programming and high speed Internet by upgrading facilities and migrating customers. It is the dominant technology by far in the residential customer class. The technology is superior for delivering video into the residential market and it was rolled out first.[50] The controversy surrounding its entry into telecommunications is also well deserved. It has entered into telecommunications with a very checkered past in its video core market, which has been unregulated for two decades. It has brought its business model from the video world into the telecommunications world.

EXHIBIT 11: MARKET SPECIALIZATION OF CABLE AND TELEPHONE ADVANCED SERVICES



Source: Sources: Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Tables 1-4.

MANIPULATION OF ACCESS

The small number of competing communications facilities creates a transmission bottleneck that leads directly to the problem of vertical leverage or market power. "[A] vertically integrated broadband provider such as AT&T will have a strong incentive and opportunity to discriminate against unaffiliated broadband content providers."[51] Even facility owners with large market shares do not hesitate to criticize the anticompetitive impacts of other facility owners who gain a large market share. They understand all too well that closed communications facilities provide leverage and an incentive to discriminate against both alternative transmission media and alternative content suppliers.

The behavioral analysis in this section relies on:

- filings presented by AT&T in Canada[52]before it became the nation's largest cable company and in the U.S. in situations where it does not possess an advantage of owning wires,[53]
- recommendations made by AOL[54] to local and federal governments before it decided to become the nation's second largest cable company,
- analyses prepared by experts for local[55] and long distance[56] telephone companies complaining about various forms of closure of networks to which they need interconnection,
- Wall Street analyses of the business models of dominant, vertically integrated cable firms,[57] and
- observations offered by independent ISPs[58] and small cable operators[59] struggling with the dominant wire companies.

Essential Communications Functions

Whether we call them essential facilities,[60] choke points[61] or anchor points,[62] the key leverage point is controlling access facilities. [63] That is exactly what AOL said about AT&T, when AOL was a nonaffiliated ISP.

> The key, after all, is the ability to use "first mile" pipeline control to deny consumers direct access to, and thus a real choice among, the content and services offered by independent providers. Open access would provide a targeted and narrow fix to this problem. AT&T simply would not be allowed to control consumer's ability to choose service providers other than those AT&T itself has chosen for them. This would create an environment where independent, competitive service providers will have access to the broadband "first mile" controlled by AT&T – the pipe into consumers' homes – in order to provide a full, expanding range of voice, video, and data services requested by consumers. The ability to stifle Internet-based video competition and to restrict access to providers of broadband content, commerce and other new applications thus would be directly diminished.[64]

Experts for the local telephone companies, in opposing the merger of AT&T and MediaOne, made exactly the same point. They argued that "the relevant geographic market is local because one can purchase broadband Internet access only from a local residence"[65] and that "a dominant market share is not a necessary condition for discrimination to be effective."[66]

> [A] hypothetical monopoly supplier of broadband Internet access in a given geographic market could exercise market power without controlling the provision of broadband access in neighboring geographic markets.[67]

The essential communications function was the paramount concern for AT&T in determining interconnection policy for cable networks in Canada.[68] AT&T attacked the claim made by cable companies that their lack of market share indicates that they lack market power. AT&T argued that small market share does not preclude the existence of market power because of the essential function of the access input to the production of service.[69] AT&T argued that open access "obligations are not dependent on whether the provider is dominant. Rather they are necessary in order to prevent the abuse of market power that can be exercised over bottleneck functions of the broadband access service."[70]

AT&T maintained that the presence of a number of vertically integrated facilities owners does not solve the fundamental problem of access that nonintegrated content providers face, and that they would inevitably be at a severe disadvantage. AT&T pointed out that since independent content providers will always outnumber integrated providers, competition could be undermined by vertical integration. In order to avoid this outcome, even multiple facilities owners must be required to provide non-discriminatory access.[71]

In early 2002, Notwithstanding the fact that AT&T owned 2 million lines in Texas that it refused to pen, it was still insisting that keeping communications networks open is critical to promoting competition.

> IN addition to allowing a variety of technologies to develop and be deployed across Texas, the state also should continue to encourage the development of competition among providers. The current provisions… authorize the Commission to ensure that such competition develops by assuring that competitors have access to essential facilities controlled by incumbent local companies, and that the competition that such access allows to develop has and will continue to inure to the benefits of Texas consumers. For example, competing providers of DSL help ensure that consumers have the option of choosing the provider with the best customer service – an issue that has been identified as one of the potential impediments to demand for broadband service today. In the absence of such competitive pressure, a single service provider does not have as much incentive to continue improving their customer service.[72]

It is ironic to note the dispute over AOL's exclusionary practices in instant messaging. The fundamental importance of communications functions was argued by Excite@Home, AT&T's ISP that provided broadband service closed proprietary basis, in demanding access to AOL's customers.

> A bedrock principle of our approach to communications has been that users of critical communications functions should be able to communicate with all others, even those who use different service providers… It would have been a disaster for the Internet if e-mail had been held captive to a proprietary technology so that users of one e-mail system could not communicate with e-mail users of a different system or if one company could dictate the terms by which all other companies could use e-mail. Instant messaging must be subject to the same principle.[73]

AOL also believed that the presence of alternative facilities did not eliminate the need for open access; it argued that

> [an open access requirement] would allow ISPs to choose between the first-mile facilities of telephone and cable operators based on their relative price, performance, and features. This would spur the loop-to-loop, facilities-based competition contemplated by the Telecommunications Act of 1996, thereby offering consumers more widespread availability of Internet access; increasing affordability due to downward pressures on prices; and a menu of service options varying in price, speed, reliability, content and customer service.[74]

It is hard to imagine private entities that possess this market power would refrain from using it to their advantage, and in fact, proprietary control of the physical facilities has not led to open networks. There was never any reason to expect otherwise, as AT&T foresaw. In Canada, AT&T tied the domination of access over the last mile to proprietary standards.[75] As concern over this advantage has grown, analysts have identified two distinct types of discrimination. Vertically integrated broadband providers may practice content discrimination or conduit discrimination. [76]

Discrimination

Content discrimination has been the focal point of concern in relation to high-speed Internet services. Content discrimination involves an integrated provider "insulating its own affiliated content from competition by blocking or degrading the quality of outside content."[77]

> Content discrimination… would benefit the cable provider by enhancing the position of its affiliated content providers in the national market by denying unaffiliated content providers critical operating scale and insulating affiliated content providers from competition. Content discrimination would thus allow the vertically integrated content provider to earn extra revenues from its own portal customers who would have fewer opportunities to interact with competing outside content.[78]

AT&T identifies four forms of anticompetitive leveraging -- bundling, price squeeze, service quality discrimination, and first mover advantage. It describes the classic vertical leveraging tools of price squeezes and quality discrimination as content discrimination.[79]

Even after AT&T became the nation's largest cable TV company, it criticized local telephone companies for abusing their monopoly control over their telephone wires. AT&T complained about bottleneck facilities, vertical integration, anticompetitive bundling of services

and distortion of competition when it opposed the entry of SBC into the long distance market in Texas.

These are the very same complaints AOL made about AT&T at about the same time.[80] AOL expressed related concerns about the manipulation of technology and interfaces:

> … allowing a single entity to abuse its control over the development of technical solutions – particularly when it may have interests inconsistent with the successful implementation of open access – could indeed undermine the City's policy. It is therefore vital to ensure that unaffiliated ISPs can gain access comparable to that the cable operators choose to afford to its cable-affiliated ISP.[81]

Long distance companies and competitive local exchange carriers have similar concerns about the merging local exchange carriers. As their experts argued in the proposed SBC-Ameritech and Bell Atlantic-GTE mergers:

> These mergers will have competition in local exchange, interexchange, and combined-service markets due to footprint effects. The economic logic of competitive spillovers implies that the increase in [the incumbent local exchange carrier (ILEC)] footprints resulting from these proposed mergers would increase the ILECs' incentive to disadvantage rivals by degrading access services they need to compete, thereby harming competition and consumers.[82]

The experts for the local telephone companies identified a series of tactics that a vertically integrated broadband provider could use to disadvantage competing unaffiliated content providers.

> First, it can give preference to an affiliated content provider by caching its content locally… Such preferential treatment ensures that affiliated content can be delivered at faster speed than unaffiliated content. Second, a vertically integrated broadband provider can limit the duration of streaming videos of broadcast quality to such an extent that they can never compete against cable programming…Third, a vertically integrated firm such as AT&T or AOL-Time Warner could impose proprietary standards that would render unaffiliated content useless…Once the AT&T standard has been established, AT&T will be able to exercise market power over customers and those companies trying to reach its customers.[83]

Wall Street analysts point out that the key to controlling the supply side is controlling essential functions through proprietary standards.[84] Independent ISPs point out that cable operators like AOL use control over functionalities to control the services available on the network.[85] Cable operators have continued to insist on quality of service restrictions by unaffiliated ISPs, which places the ISPs at a competitive disadvantage.[86] Cable operators must approve new functionalities whether or not they place any demands on the network.[87] AT&T's control of the architecture is just as explicit. It will pick and choose which service providers get the fastest speeds. The favored service providers are those affiliated with AT&T.[88]

Conduit discrimination has received less attention in the high speed Internet area. Nevertheless, there are examples in the high speed Internet market. In implementing conduit discrimination, the vertically integrated company would refuse to distribute its affiliated content over competing transmission media.[89] In so doing, it seeks to drive consumers to its transmission media and weaken its rival. This is profitable as long as the revenue gained by attracting new subscribers exceeds the revenue lost by not making the content available to the rival.

Although some argue that "the traditional models of discrimination do not depend on the vertically integrated firm obtaining some critical level of downstream market share,"[90] Market size is important here, to ensure adequate profits are earned on the distribution of service over the favored conduit.[91] In reality, the size of the vertically integrated firm does matter since "a larger downstream market share enhances the vertically integrated firm's incentive to engage in discrimination."[92]

AT&T has been accused of conduit discrimination in the high speed Internet market.

> CTN [CT Communications Network Inc.], a registered and franchised cable operator, has been unable to purchase the affiliated HITS transport service from AT&T Broadband, the nation's largest cable operators, despite repeated attempts to do so…. Based on its own experience and conversations with other companies who have experienced similar problems, CTCN believes that AT&T is refusing to sell HITS to any company using DSL technology to deliver video services over existing phone lines because such companies would directly compete with AT&T entry into the local telephone market using both its owns system and the cable plant of unaffiliated cable operators. AT&T simply does not want any terrestrial based competition by other broadband networks capable of providing bundled video, voice and data services.[93]

The AOL-Time Warner merger raised similar concerns about conduit discrimination. The significance of the AOL switch to cable-based broadband cannot be underestimated in the damage that it does to the hoped-for competition between cable modems and DSL.[94] Although the telephone companies are reluctant to admit that their technology will have trouble competing, their experts have identified the advantages that cable enjoys.[95] Fearing that once AOL became a cable owners it would abandon the DSL distribution channel, the FTC required AOL to continue to makes its service available over the DSL conduit.

Bundling and Customer Lock In

Bundling early in the adoption cycle to lock in customers is the focal point of the leveraging strategy. AT&T described the problem with the bundling technique that local telephone companies (local exchange carriers or LECs) might use to gain an advantage.[96]

AOL described the threat of vertically integrated cable companies in the U.S. in these terms:

> At every link in the broadband distribution chain for video/voice/data services, AT&T would possess the ability and the incentive to limit consumer choice. Whether through its exclusive control of the EPG or browser that serve as consumers' interface; its integration of favored Microsoft operating systems in

> set-top boxes; its control of the cable broadband pipe itself; its exclusive dealing with its own proprietary cable ISPs; or the required use of its "backbone" long distance facilities; AT&T could block or choke off consumers' ability to choose among the access, Internet services, and integrated services of their choice. Eliminating customer choice will diminish innovation, increase prices, and chill consumer demand; thereby slowing the rollout of integrates service.[97]

Once AT&T became the largest vertically integrated cable company selling broadband access in the U.S., it set out to prevent potential competitors from offering bundles of services. Bundles could be broken up either by not allowing Internet service providers to have access to video customers, or by preventing companies with the ability to deliver telephony from having access to high-speed content

AOL argued that requiring open access early in the process of market development would establish a much stronger structure for a proconsumer, procompetitive market. Early intervention prevents the architecture of the market from blocking openness and avoids the difficult task of having to reconstruct an open market at a later time. AOL did not hesitate to point out the powerful anticompetitive effect that integrating video services in the communications bundle could have. AOL argued that, as a result of a vertical merger,

> … AT&T would take an enormous next step toward its ability to deny consumers a choice among competing providers of integrated voice/video/data offerings – a communications marketplace that integrates, and transcends, an array of communications services and markets previously viewed as distinct.[98]

Wall Street sees the first mover advantage both in the general terms of the processes that affect network industries and in the specific advantage that cable broadband services have in capturing the most attractive early adopting consumers.[99] First mover advantages have their greatest value where consumers have difficulty switching or substituting away from the dominated product. Several characteristics of Broadband Internet access are conducive to the first mover advantage, or "lock-in".

The local telephone company experts outlined a series of concerns about lock in.[100] First; high-speed access is a unique product. The Department of Justice determined that the broadband Internet market is a separate and distinct market from the narrowband Internet market.[101] Once this obvious economic fact is accepted, the severe concentration in the broadband market – resulting in a high degree of market power – and the blatantly anti-competitive effect of the exclusionary tactics of the dominant broadband firms become apparent, even to AT&T.[102]

The local telephone company experts devote a great deal of attention to demonstrating that the broadband market is a distinct market.[103] There is no doubt that "high-speed seems to be a distinctive product, making it a credible wedge for cable to sell a broader bundle."[104] For the Wall Street analysts, bundling is the central marketing strategy for broadband.[105]

Second, there are significant switching costs that will hinder competition. The equipment (modems) and other front-end costs are still substantial and unique to each technology. There is very little competition between cable companies (i.e. overbuilding). Thus, switching costs remain a substantial barrier to competition. Combining a head start with significant switching costs raises the fear among the independent ISPs that consumers will be

locked in. In Canada, AT&T argued that the presence of switching costs could impede the ability of consumers to change technologies, thereby impeding competition.

> [T]he cost of switching suppliers is another important factor that is used to assess demand conditions in the relevant market. In the case of the broadband access market, the cost of switching suppliers could be significant, particularly if there is a need to adopt different technical interfaces or to purchase new equipment for the home or office. Given the fact that many of the technologies involved in the provision of broadband access services are still in the early stages of development, it is unlikely that we will see customer switching seamlessly form one service provider to another in the near-term.[106]

The emerging model for closed communications platforms is one in which the facility owner with a dominant technology that is a critical input for service delivery can leverage control of transmission facilities to achieve domination of content services. With proprietary control over the network for which there is a lack of adequate alternatives, they can lock in consumers and squeeze competitors out of the broader market. Lock-in occurs because the high-speed access is a distinct market for a product with significant switching costs.

CABLE INDUSTRY LEVERAGING OF ITS BOTTLENECK

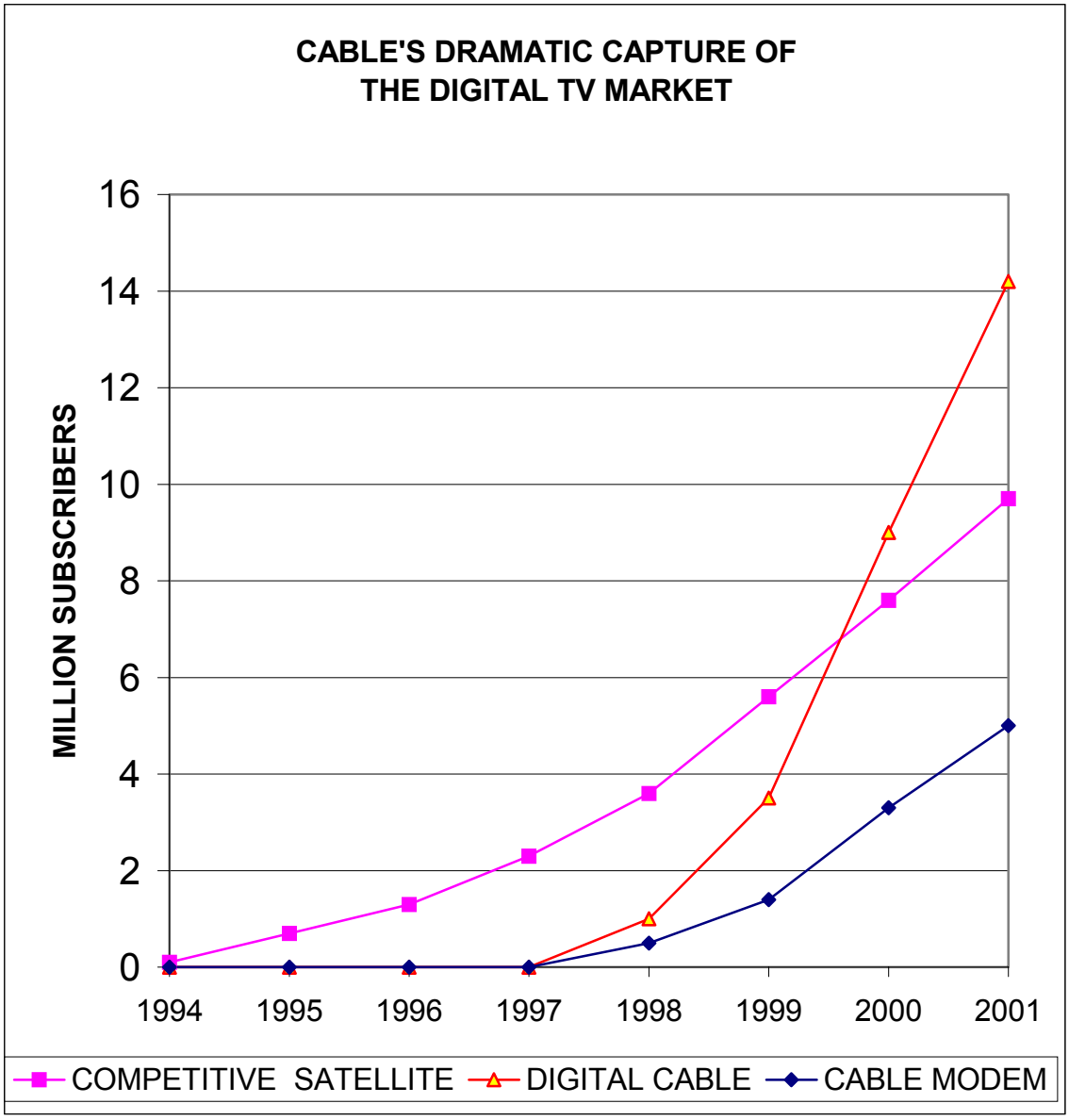
Exhibit 2 above showed the dramatic capture of the digital MVPD market by cable operators. Exhibit 12 restates that data based only those markets in which satellite and cable compete head-to-head because it is important to recognize that a substantial part of the satellite subscriber base is rural and not served by cable. Indeed, much of that rural base will have difficulty obtaining high-speed Internet, as cable does not serve them (or is not inclined to upgrade those systems), satellite has little capacity to provide high-speed Internet, and long rural telephone loops are least likely to be upgradeable for high speed Internet through the telephone network. The exhibit also includes cable modem penetration.

Cable companies have achieved a much higher take rate of digital TV than high speed Internet. The cable companies have migrated three times as many customers from analog to digital in the video market than in the Internet market.

Exhibit 13 presents the whole digital market (all satellite and cable) and the entire Internet market (narrowband and high-speed). When we look at the Internet market, we find a rather different pattern than digital. What we observe is rapid penetration but much slower migration to high-speed service. The residential Internet market has reached about over 50 million, but high speed Internet is around 10 million. As a result, the Internet and the MVPD markets have been converging in total size, but the digital services within these markets have begun to diverge.

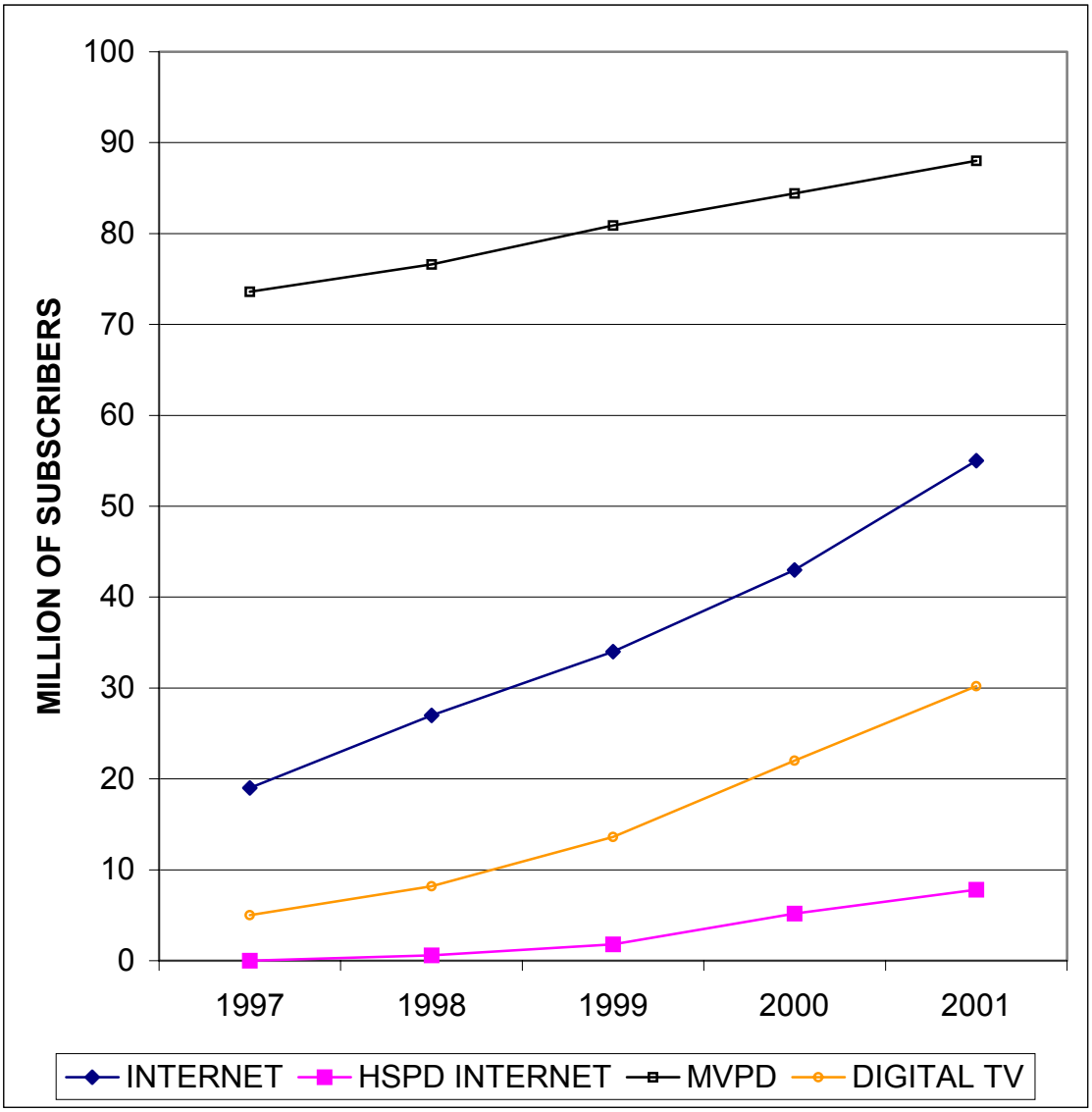
Putting the penetration of these four products on one graph underscores the complexity of the analysis, but also the basic policy concern. The product we are inquiring about – high-speed Internet – is clearly doing the worst. We might say that penetration is only 10 percent. However, since only half of all households have taken the Internet, and only 80 percent of all households could take high-speed, the base of the calculation could be adjusted. To be fair, perhaps we should say that the penetration is about 20 percent. Cable accounts for about two thirds of the total, or penetration of 6.5 to 13 percent of all households.

EXHIBIT 12: MARKET SHARES FOR DIGITAL MULTICHANNEL VIDEO PROGRAMMING DISTRIBUTION WHERE CABLE AND SATELLITE COMPETE



Source: Competitive Satellite is 60 percent of DBS in 2001 and 40 percent in 1994 with the percentages assumed to change smoothly between the two dates; Cable Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 26; Federal Communications Commission Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141, December 31, 1997, para 36; Sixth Annual Report, CS Docket No. 99-230, December 30, 1999, para 54; Seventh Annual Report, CS Docket No. 00-132, January 2, 2001, para 66; Eight Annual Report, CS Docket No. 01-129, January 14, 2002, paras 38, 58.

EXHIBIT 13: MVPD, CABLE TV, INTERNET AND HIGH-SPEED INTERNET PENETRATION



Source: Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 26; Federal Communications Commission Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141, December 31, 1997, para 36; Seventh Annual Report, CS Docket No. 00-132, January 2, 2001, para 66; Eight Annual Report, CS Docket No. 01-129, January 14, 2002, paras 38, 58; Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Table 1. National Telecommunications and Information Administration, *A Nation Online: How Americans Are Expanding Their Use of the Internet* (U.S. Department of Commerce, 2002), Figure 1-1

The performance of multichannel video program distribution (MVPD) is strikingly better. This market is over 85 million, or 70 percent larger than the residential Internet markets. With over 30 million households taking digital TV (including non-competitive satellite), the market penetration is between 30 and 40 percent (depending on which numerator and denominator are chosen). No matter how we make the comparison, digital TV is penetrating much more quickly. If we restrict ourselves to digital over cable, however, we find that the take rate is about 20 percent.

Strategic Pricing of High-Speed Internet Access

Why is the digital tier doing so much better than high-speed Internet access? Any good economic analysis should start with the master variable – price.

Cable has priced digital TV services much more aggressively to stimulate penetration. Cable imposes an incremental price to migrate from narrowband to broadband that is substantially higher than it charges to migrate from analog cable to digital cable in both monetary and qualitative terms.

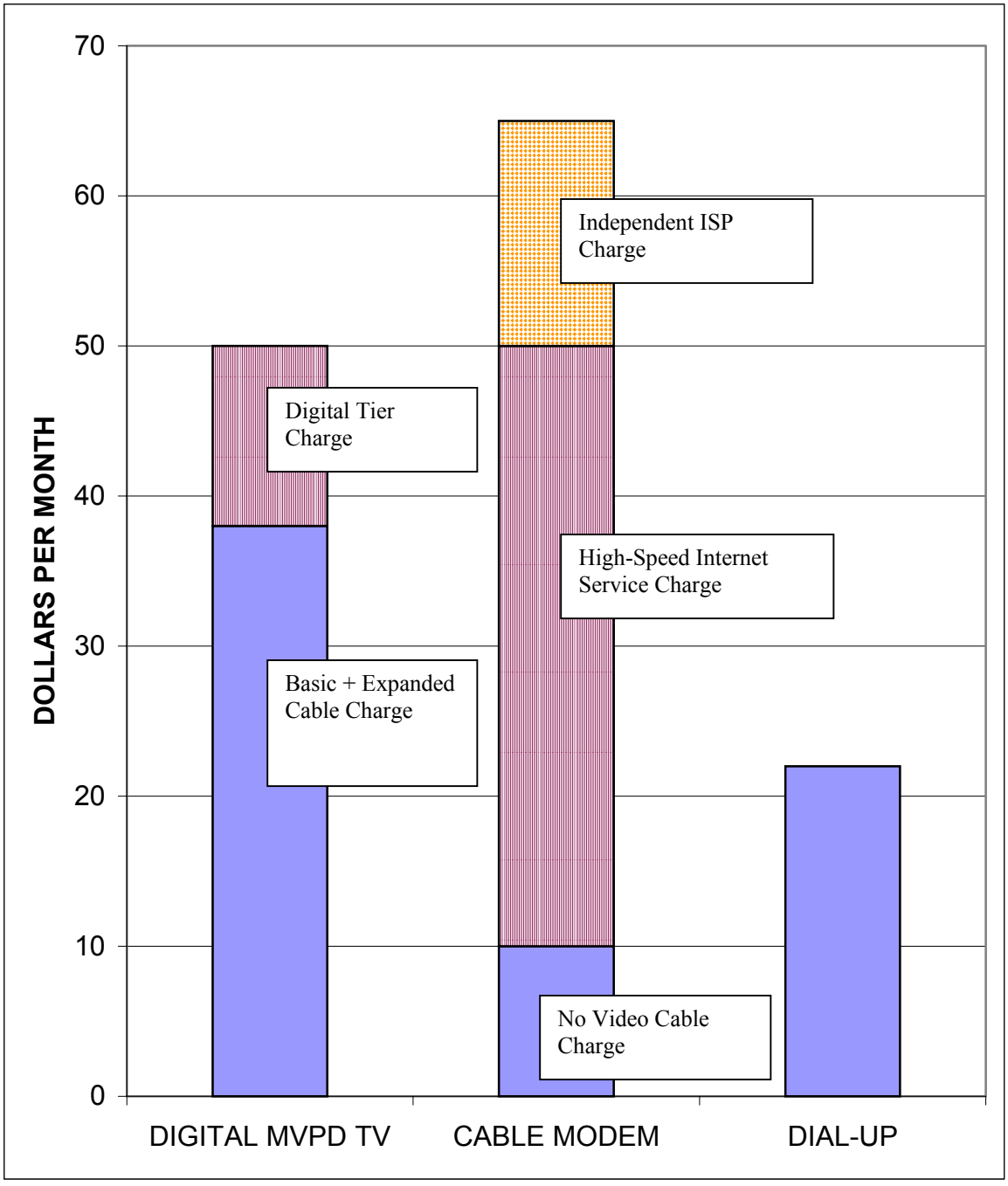
This becomes quite apparent to any consumer who tries to buy the service in the marketplace (see Exhibit 14). If a consumer adds a digital tier, the charge would be an additional $10-$12 (on average). If a consumer requests cable modem service, but not cable TV service, the charge will be $10 for the use of the basic cable facilities, an additional $40 for the cable company's chosen ISP to provide an Internet connection, and $15 for my current ISP. The total would be $65. If the consumer takes cable, the incremental cost would be $55. This service is not being priced to penetrate.

The difference is striking and there appears to be no cost justification. Indeed, a Morgan Stanley Dean Witter analysis entitled *Digital Decade* found that the incremental capital costs for digital cable were higher than high-speed Internet added to a cable upgrade. In their report entitled *Broadband!* Bernstein/Mckinsey reached the same conclusion. The example given in the NRC report, which appears to be for a new overbuild, fiber system, suggests that the capital costs would be equal.

This pricing scheme implicitly suggests that the basic network costs $10 (the incremental charge for stand alone high-speed service). It implicitly suggests that the digital upgrade costs are about $10 (the charge for the digital tier). Pure transmission should be about $20.

Other evidence suggests that that the customer care, billing and incremental facility costs for Internet service providers is in the range of $10-$15 dollars. These costs include real services, like customer service (billing and customer care), customer acquisition, and deployment of their own facilities, like points of presence, local caching, and centralized computing. AOL charges $15 (recently up from $10) to get their service as a buy through on the cable systems from which they have been excluded. Limited use narrowband Internet plans are available at $10 per month, which suggests this is the basic cost per customer. Indeed, AOL was a profitable, narrowband company at $20 per month for full service customers. This is exactly what Bernstein/Mckinsey concluded in *Broadband!* Cable operators report this cost is less than $10.[107]

EXHIBIT 14: STRATEGIC PRICING OF CABLE MODEM SERVICE



Sources: Visits to Cable company and Internet Service Provider Web sites; Consumers Union Survey of Satellite and Cable Subscribers, September 2001.

The $50 price tag that the cable operators have put on cable modem service and the $65 it costs to choose the most popular Internet service provider as a stand alone service on the technologically preferred delivery systems for broadband is driven by the raw exercise of market power. Bill Gates' suggestion that this service should be priced at $30 may be too generous, if only facility costs are included. In any event, this service is being dramatically overpriced.

The implication is that cable operators are extracting massive monopoly rents. Tom Hazlett has characterized the situation as follows.[108]

> **Cable operators possess substantial market power in subscription video markets**. Moreover, they use this leverage to restrict output in broadband access. This is not profitable in a narrow financial calculus, but is rational due to strategic considerations…

The price increases of 2001 confirm the willingness of cable operators to forego sales to increase profits. The financial analysis provided by Bernstein/McKinsey showed a three year break-even and an after tax rate of profit of 23% before last year's price increase. The price increase would push that figure up to 36 percent and shorten the payback.

The cable operators have carried the lessons of market power in the MVPD market into the high-speed Internet market. They pick-up the high value early adopters by being first and bundling. Keeping prices high creates a high rate of profit. They get the benefit of having the best customers locked-in to their technology.

Strategic Manipulation of Access by Cable Companies

The exercise of cable market power does not take only the form of pricing abuse. Incumbent cable operators also raise barriers to entry. Between 1984 and 1992, cable operators leveraged their control over programming to prevent satellite from gaining a foothold. It took an Act of congress to free up this critical strategic input, although they have been allowed to reinvent that strategy through the loophole of terrestrial transmission. Now the strategic input is access to the telecommunications functionality of the cable systems.

The FCC and the cable companies (telephone companies as well) offer voluntary commercial access as a substitute for non-discriminatory interconnection and carriage that have traditionally been part of the communications industry. Voluntary commercial access is nowhere near what is needed to preserve the competitive, consumer-friendly, innovation rich environment we have come to know and love on the Internet.

The commercial access that AOL, AT&T and Comcast are offering involves the following. The network owners

- choose a small number of ISPs who can sell a restrictive set of services;
- tell the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;

- control the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and

- place independent ISPs in a price squeeze that stifles innovation on the Internet by charging a toll for access (the charge unaffiliated ISPs must pay for carriage) that is so high that there are few resources and little market left for new applications or content.

Restricting interconnecting companies to specific types of services, such as Internet access sales only, precludes a range of other intermediary services and functions provided by ISPs to the public (e.g. no ITV functionality). Restriction of service to specified appliances retards competition for video services. Control of quality and functionalities and restriction of end-user applications by the network owner precludes potentially competing video services and other Internet oriented services from developing.

Network owners seek to impose uniformity in pursuit of their commercial interests and foreclose the ability of competitors to differentiate themselves by restricting privacy policy and billing and payment practices. Network owners prevent real competition by demanding control over valuable first screen real estate. They retain the right to approve the ISP home page and demand to have a prominent "above the fold" spot on the home page over which they retain complete control. They demand preferential bundling of services and control of cross marketing of services. Network owners stake a claim to all customer information generated by the ISP.

Network owners establish a revenue "ceiling" on independent ISPs. They demand a huge share of both subscription (65-75%) and ancillary revenues (25% or more) the ISP generates, but keep all of the ancillary revenues they generate in connection with the ISP service. At the same time, they establish a high price floor under sales of Internet service to cable TV customers. This squeezes the margin on such customers and renders potential video stream competitors vulnerable to price squeeze.

Short three-year contracts come with severe conditions, such as imposing a very short-term perspective on independent ISPs by denying the ISP a contract with terms longer than three years and denying the ISPs an inextinguishable right to provide service. The ISP does not have a right to continue selling the service if the system is sold and the right to sell service is not extended to systems that are acquired. In other words, the ISP can simply be shut down by the new cable owner or be prevented from extending its business to a neighboring system. A large nonrefundable deposit and minimum size requirement would keep small and niche market ISPs off the network.

Under these conditions, the commercial space left for the unaffiliated and smaller ISPs (where much innovation takes place) is sparse and ever shrinking. Hazlett and Bittlingmayer cite Excite@Home executive Milo Medin describing the terms on which cable operators would allow carriage of broadband Internet to AOL (before it owned a wire) as follows:

> I was sitting next to [AOL CEO] Steve Case in Congress during the open access debates. He was saying that all AOL wanted was to be treated like Excite@Home. If he wants to be treated like us, I'm sure he could cut a deal

> with [the cable networks], but they'll take their pound of flesh. We only had to give them a 75 percent equity stake in the company and board control. The guys aren't morons.[109]

The fate of Excite@Home speaks volumes about the nature of the commercial deals for access that are being voluntarily offered.

Placing these severe restrictions on independent ISPs is a strategy that protects the cable company's paramount interest in preserving its market power over video entertainment. These policies make it impossible for ISPs to directly compete for video service, but the strategic manipulation of access to the customer goes farther. The companies appear to be backsliding on their promise that there will be unfettered, click through access to the Internet. Restrictions on the flow of rich media and video content are being imposed, unless the gatekeeper collects the full monopoly rents it expects from video. Anything that competes for that market will be squeezed at the tollgate.

Cable operators have a strong incentive to retard innovation that might compete directly with their core video services, or even indirectly for consumer video entertainment attention. Restricting the number of service providers and the services they can provide ensures cable companies control the flow of innovations and takes away the incentive to develop new applications. This is the antithesis of how the Internet was created. In the narrowband Internet, intramodal competition at the level of content – ensuring that content providers and applications developers were given non-discriminatory access to facilities – was highly successful in stimulating entry and innovation.

The cable operators' closed networks are apparent in the statistics of high-speed Internet access providers.[110] There are only 47 high-speed Internet service providers using cable modem service nationwide – essential the monopoly cable companies offering service on an exclusive basis in their franchise areas. This number has been virtually constant for past two years. There are almost three times as many high-speed Internet access service providers using other technologies, and this number has almost doubled in the past two years.

IV. THE PUBLIC POLICY ISSUE

RESTATING THE POLICY PROBLEM IN ECONOMIC TERMS

The public policy problem can be rendered in formal and quantitative economic terms of market structure and market power analysis

Economic public policy is primarily concerned with market performance.[111] The concept of performance is multifaceted, including both efficiency and fairness.[112] The measures of performance to which we traditionally look are pricing, quality, and profits. They are the most direct measure of how society's wealth is being allocated and distributed.

The performance of industries is determined by a number of factors, most directly the conduct of market participants. Do they compete? What legal tactics do they employ? How do they advertise and price their products?[113] Conduct is affected and circumscribed by market structure. Market structure includes an analysis of the number and size of the firms in the industry, their cost characteristics and barriers to entry.[114] Market structure is influenced by basic conditions, such as the elasticities of supply and demand and the constraints of available technologies.[115]

Market structures that support competition are the primary goal of public policy because "[c]ompetition has long been viewed as a force that leads to an ideal solution of the economic performance problem, and monopoly has been condemned."[116] The predominant reason for the preference for competitive markets reflects the economic performance they generate, although there are political reasons to prefer such markets as well.[117] In particular, competition fosters an efficient allocation of resources, the absence of profit, the lowest cost production, and a strong incentive to innovate.[118] Where competition breaks down, firms are said to have market power[119] and the market falls short of these results.[120] Pure and perfect competition is rare, but the competitive goal is still valid.[121] Therefore, public policy pays a great deal of attention to the relative competitiveness of markets as well as the conditions that make markets more competitive or workably competitive.[122]

Market structure analysis identifies situations in which a small number of firms control a sufficiently large part of the market to make coordinated or reinforcing activities feasible. Through various implicit and explicit mechanisms, a small number of firms can reinforce each other's behavior rather than compete. Identification of when a small number of firms can exercise this power is not a precise science. Generally, however, when the number of significant firms falls into the single digits, there is cause for concern, as the following suggests.

> Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.[123]

MEASURES OF MARKET POWER

Market Structure – the Number and Size of Firms and the HHI

The DOJ defines levels of concentration to determine the extent of review of mergers in terms of the Herfindahl-Hirschman Index (HHI). [124] This measure takes the market share of each firm, squares it, sums the result, and multiplies by 10,000. [125] A second method to quantify market concentration is to calculate the market share of the largest 4 firms (4 firm concentration ratio or CR4).

Under its Merger Guidelines, the DOJ considers a market with an HHI of 1000 or less to be unconcentrated (see Exhibit 15). Such a market would have the equivalent of ten equal sized competitors. In such a market, the 4-firm concentration ratio would be 40 percent. Any market with a concentration above this level is deemed to be a source of concern. The DOJ considers an HHI of 1800 as the point at which a market is considered highly concentrated. This level falls between five and six equal-sized competitors.

EXHIBIT 15: DESCRIBING MARKET CONCENTRATION FOR PURPOSES OF PUBLIC POLICY

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE
↑	Monopoly	1 (with 65% or more)	5300+	100
↑	Duopoly	2	3000+	100
Highly Concentrated	↑		1800	
↑	Tight Oligopoly	6	1667	67
Moderately Concentrated	↑			
Unconcentrated	Moderately Concentrated	10	1000	40
↓	↓			
↓	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger* Guidelines, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration ratios.

Shepherd describes these thresholds in terms of four-firm concentration ratios as follows:[126]

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.
>
> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible. Shepherd refers to collusion in his discussion, but it is important to note that is not the only concern of market power analysis or the Merger Guidelines.

The DOJ Guidelines are oriented toward conditions under which a broad range of types of anticompetitive behaviors are sufficiently likely to occur to require regulatory action. The Merger Guidelines recognize that market power can be exercised with coordinated, or parallel, activities and even unilateral actions in situation where there are small numbers of market players.[127] The area of noncollusive, oligopoly behavior has received a great deal of attention. A variety of models have been developed in which it is demonstrated that small numbers of market participants interacting in the market, especially on a repeated basis, can learn to signal, anticipate, and parallel one another to achieve outcomes that capture a substantial share of the potential monopoly profits. This leads us to identify several other specific types of markets when such behavior is more or less likely.

First, the highly concentrated category can be broken down into two types of markets that are a special source of concern. Although the expression 'monopoly' technically refers to one firm, antitrust practice refers to monopoly power when the market share of a firm rises to the level of 60 to 70 percent. In both these cases the CR4 would be 100. The HHI can vary, depending on the size of the second firm in the market. A dominant firm with a market share of 65 percent and ten small firms would result in an HHI of about 4,300. A 'duopoly' refers to a market with only two firms. Two equal sized firms would be a duopoly with an HHI of 5,000. As a practical matter in media markets we observe that monopoly situations where the leading firm has over 65 percent of the market share exhibit HHIs of 5,300 or higher. Duopolies where two firms are generally fall in the 60/40 percent range; exhibit HHIs between 3000 and 5300.

On the other hand, we should not forget that although ten firms constitute an unconcentrated market, that number does not ensure vigorous competition. Generally, a much higher number, perhaps fifty, is associated with the concept of vigorous or atomistic competition. With 50 equal size competitors, the HHI would be 200 and the CR 4 would be 8.

Shepherd refers to collusion in his discussion, but it is important to note that is not the only concern of market power analysis or the Merger Guidelines. The DOJ Guidelines are oriented toward conditions under which a broad range of types of anticompetitive behaviors are sufficiently likely to occur to require regulatory action. The Merger Guidelines recognize that market power can be exercised with coordinated, or parallel, activities and even unilateral actions in situation where there are small numbers of market players.

The area of noncollusive, oligopoly behavior has received a great deal of attention. A variety of models have been developed in which it is demonstrated that small numbers of market participants interacting in the market, especially on a repeated basis, can learn to signal, anticipate, and parallel one another to achieve outcomes that capture a substantial share of the potential monopoly profits.[128]

Other Measures of Market Power – the Lerner Index and Tobin's q

The public policy goal we have outlined in theory and that Congress has clearly articulated in its directives to the FCC is to prevent the abuse of market power. The primary measure of that harm is in the impact it has on prices and efficiency, although increasing attention is paid to quality and innovation. Price analysis focuses on the firm's ability to set price above cost to achieve above normal profits.

This analytic framework has been articulated by prominent "liberal" (Scherer and Ross) and "conservative" economists (Landes and Posner)[129] with a focus on the Lerner index, to which the horizontal limit notice refers.[130] The *Lerner Index* is the extent to which prices are marked up over costs, defined as[131]

$$L = (\text{Price} - \text{Marginal Cost})/\text{Price}^{132} = \frac{P - MC}{P} = \frac{1}{E}$$

We have already noted the evidence that the elasticity of demand is low. Viscusi, Vernon and Harrington use the Lerner index to derive an application for (Cournot) oligopoly situations that pulls the discussions of the HHI and the Lerner Index together.

$$L = = \frac{P - MC}{P} = \frac{1}{nE} = \sum s_i \times \frac{P^c - c_i}{P^c} = \frac{HHI}{10{,}000\ E}$$

where:

n = the number of firms

E = elasticity of demand in the market

s_i = market share of the i^{th} firm

P^c = Cournot Price

c_i = cost of the i^{th} firm

They point out "the HHI is directly related to a weighted average of firms' price-cost margins… [t]he higher is the HHI, the higher is the industry price-cost margin.[133]

If prices were set above costs, we would expect market power to be observable in a heightened level of profitability. Scherer and Ross describe a series of profitability measures that includes profit margins, return on equity, and return on investment. One of the other measures of profitability identified by Scherer and Ross is Tobin's q, which "captures the deviation between the market value of a firm and the replacement cost of its assets."[134]

$$q = \frac{M_C + M_P + M_D}{A_R}$$

The numerator is the sum of all common and preferred stock plus outstanding debt. The denominator is the cost of replacing total assets. The logic is straightforward since "in an industry that meets all the conditions of pure competition, the q ratio should be one." Supranormal profits would attract entry. This means that if entrepreneurs could simply enter

the market and put up competing systems, they could do so at a much lower cost. Needless to say, if competitors could actually enter the market, incumbent firms could not command such a premium price for their systems. Scherer and Ross note that all of the profitability measures present problems, but they are all highly correlated. The Commission asks specifically about Tobin's q as a measure of market power distinct from the Lerner index discussed above. [135]

LOCAL AND NATIONAL MVPD MARKET CONCENTRATION

1. Local Markets Are a Virtual Monopoly

Head-to-head competition between cable companies is virtually non-existent. Out of 3000 plus cable systems, head-to-head competition exists in fewer than 200, although another 150 have certified entry. In short, only about 1 percent of franchise territories have experienced head-to-head competition between cable companies. While a number of other communities have authorized additional overbuilding, this activity is slowing, as the regional bell operating companies pull back and pure overbuilders retrench.[136]

Cable's dominance as the multichannel medium is overwhelming, with a subscribership of approximately two-thirds of all TV households. Its penetration is about four times as high as the next multichannel technology, satellite. Because a large number of satellite subscribers live in areas that are not served by cable, competition in geographic markets is less vigorous than the national totals suggest.

This monopoly at the point of sale is reinforced by a strong trend toward regionalization in which one company gains ownership of many firms in a region. Clustering has increased sharply since 1994, up by almost 75 percent.[137] Just over one-half of all subscribers were clustered in 1997 but by 2000 four-fifths were.[138] The FCC has found that clustering is associated with higher prices.[139]

The failure of competition in multichannel video is most evident in local markets. Only one cable company serves over 95 percent of the homes passed in the country.[140] Satellite has about 10 million subscribers in markets where cable and satellite meet. In these markets, there are only 8 million satellite only subscribers. This suggests that cable retains a market share at the point of sale of well over 85 percent.[141] The HHI index at the local level is above 7000. As discussed above, these market shares and levels of concentration for cable operators are virtual monopolies.[142]

2. National Markets

The wave of concentration in the industry after deregulation is striking at the national level (see Exhibit 16). When cable was deregulated in 1984, the distribution segment was not concentrated at all (HHI about 350), with the equivalent of about 30 equal sized competitors. A decade later, concentration had advanced to the point where the distribution segment had the equivalent of about 11 equal-sized competitors (HHI about 930). This is just close to the moderately concentrated threshold.

EXHIBIT 16: CONCENTRATION OF NATIONAL CABLE EYEBALL MARKET

YEAR		4-FIRM	HHI
1984		28	360
1992		48	930
2001	FCC without attribution	52	905
	with attribution	56**	1101
	with attribution + Cablevision	60***	1254
	with attribution + Cablevision + TWE	68****	1923
AT&T/ Comcast	with attribution	64	1529
	with attribution + Cablevision	70	1749
	with attribution + Cablevision + TWE	77	2676

SOURCES AND NOTES: Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, First Report, CC Docket No. 94-48, Eighth Report, CC Docket No 00132; Applications and Public Interest Statement In *the Matter of Application for Consent to the Transfer of Control of Licenses Compact Corporation and AT&T Corp. Tansferors to AT&T Comcast Corporation*, *All* estimates are rounded to the nearest 10.

*The FCC double counts subscribers to both cable and satellite. In previous analyses, we have placed the MVPD market at 86 million rather than 88.3 million. This has caused some confusion. Since AT&T is claimingcompliance by hundredths of a percent, we use the unduplicated count of 86 million.

**With attribution puts AT&T now claims 18.8 million subscribers having very recently sold off cablevision stock to get its ownership share to 4.98%.

***AT&T claims of technical compliance with the attribution rules, or its ability to remain in compliance, given how close it has chosen to stay to the limit of non-attribution have yet to be demonstrated. Cablevision is estimated to have 3 million subscribers.

**** AT&T's efforts to divest its TWE holdings have been unsuccessful to date. The attributable TW subscribers are estimated at 11.35 million.

Although the FCC claims that the MVPD market falls just below the level of being moderately concentrated (HHI = 954), it arrives at this conclusion by ignoring AT&T's substantial ownership interests in Cablevision and AOL Time Warner. Taking AT&T's ownership interests into account places the cable TV market into the moderately concentrated category.

THE CURRENT LACK OF COMPETITION IN BROADBAND

The recent report by the National Research Council proposed an interesting typology of broadband markets from the point of view of competition.

Type 0 – no terrestrial providers of broadband.

Type 1 – one terrestrial facility-based provider in the area (e.g., cable but not DSL or *vice versa*).

Type 2 – two terrestrial facilities-based providers.

Type 3 – one or more facilities based providers that install new infrastructure to compete with incumbents.[143]

Their approach to categorizing these markets reminds us that there are liable to be "no-opolies," situations in which no full service broadband facility is available. It also drives home the point that terrestrial wire-based services (today: telephone wireline or cable modem service) are likely to dominate.

As a practical matter, using the Department of Justice Merger Guidelines, and general economic literature, as well as the National Academy of Science typology we arrive at the following categories to describe media markets.

"No-opoly" – no full service provider available

Monopoly – 1 dominant firm

Duopoly – 2, relatively equal-sized firms that dominate the market

Tight oligopoly – 3 to 5 large firms

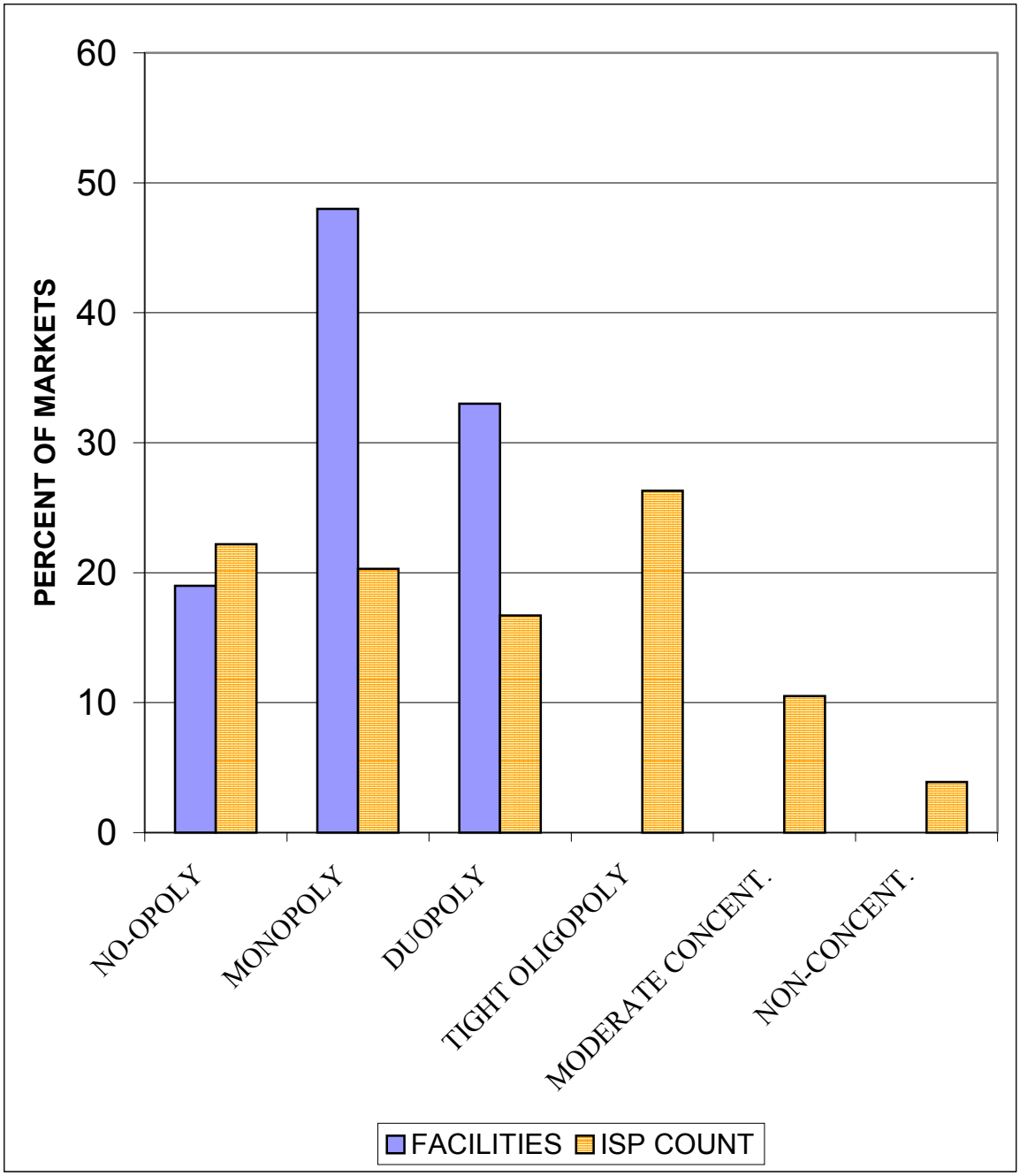
Moderately concentrated – 6 to 9 firms

Unconcentrated – 10 or more firms

Atomistic Competition – 50 firms

The FCC publishes data on the availability of high-speed Internet services from ISPs[144] by zip codes, which shows the product space is highly concentrated at best (see Exhibit 17).

EXHIBIT 17: MARKET STRUCTURE OF HIGH-SPEED INTERNET ACCESS SERVICE



Source: Sources: Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Table 9; Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 36.

A recent J.P. Morgan analysis of the availability of facilities reaches a similar conclusion.[145] Both show that about one-fifth of the nation does not have high-speed service. The FCC's ISP data shows that another one-fifth of zip codes are monopolies, slightly less than one fifth are duopolies and a quarter are tight oligopolies. Only 10 percent of zip codes are moderately concentrated and four percent are unconcentrated. J. P. Morgan estimates that in addition to the one-fifth of the country that has no supplier, almost one-half of the country is subject to a facility monopoly. The final one-third has a facility duopoly.

CURRENT LACK OF FACILITIES-BASED COMPETITION IN TELEPHONY

Competition for local telephone service is more widespread than broadband, but these markets are far from unconcentrated. (See Exhibit 18). By zip codes, two fifths have no competition. Approximately 16 percent are a monopoly and 10 percent are a duopoly. Just under one fifth is a tight oligopoly. Only 6 percent are unconcentrated. Less densely populated areas are less likely to have competition, so the picture is somewhat better on a population-weighted basis. Approximately one tenth of the nation has no competition, with 9 percent being a monopoly and another 9 percent being a duopoly. Three-tenths are tight oligopolies. One quarter is moderately concentrated and one-sixth is unconcentrated.

This analysis mixes both intramodal and intermodal competition. If we think of facilities-based competition as customers who take their basic service over specific types of utilities, we conclude that about 90 percent of accounts are still based on wireline incumbent service.

Only a very small percentage of customers (2-4 percent) have given up wireline service and relies on wireless only. This reflects the fact that for basic local service, wireless is not an attractive alternative. For Internet access, it is not much of an alternative at all at present.

Another 1 percent of customers have taken cable telephone service. These are almost entirely in the residential customer class.

Another 3 percent receive service for entirely separate wireline facilities. These are largely in the business customer class.

Another 2 percent receive service from partially separate facilities (i.e. by using unbundled network elements).

Another 2 percent is based on UNE-P, which is overwhelmingly reliant on the incumbent network.

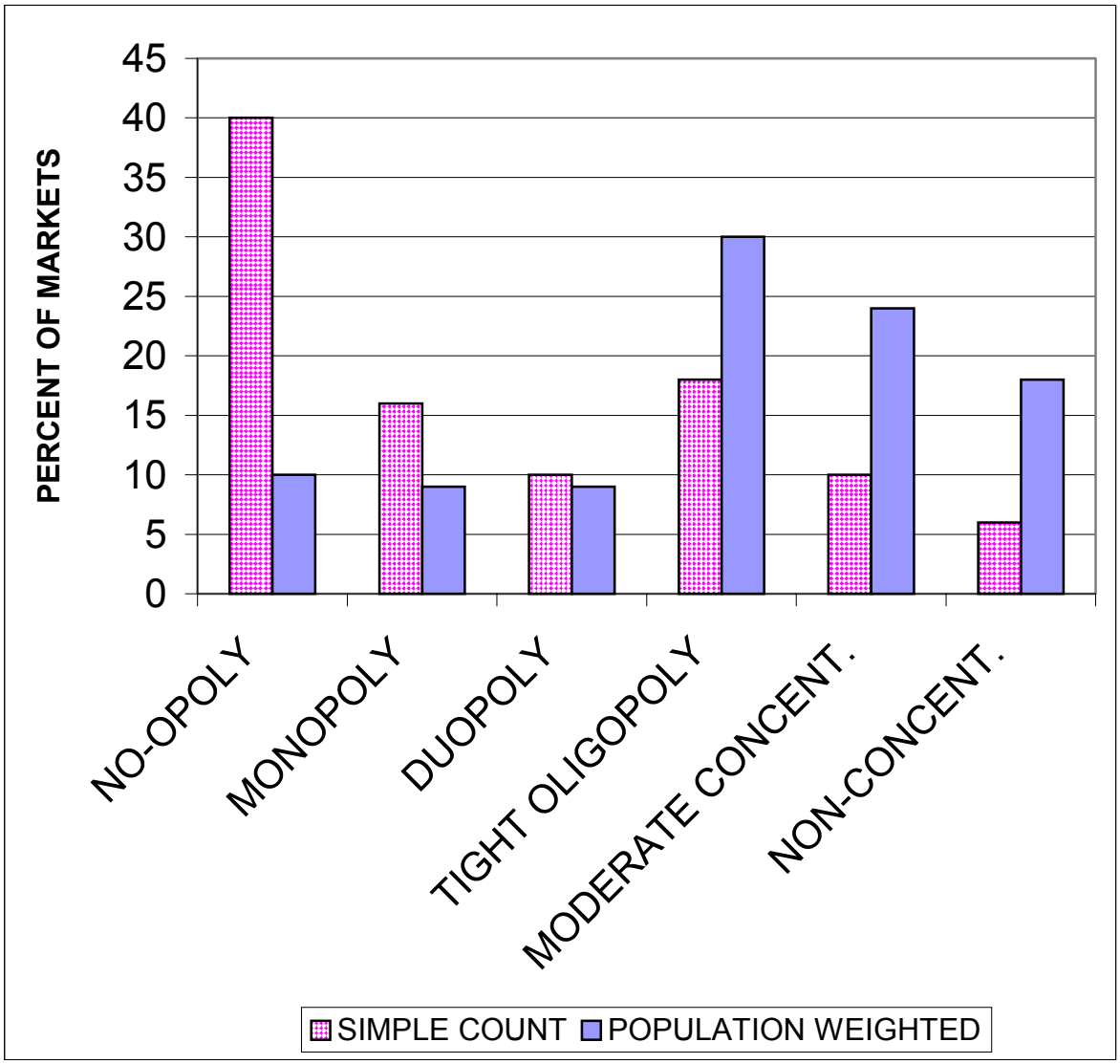
Another 4 percent is pure resale.

Intramodal competition – competition that relies at least in part on the use of the existing network through resale and UNE-based service – is about twice as large as pure facilities based competition.

To date, facilities-based intermodal competition has taken about a 4 percent market share.[146] Facilities-based intramodal competition that is not dependent on unbundled network elements has taken about a 4 percent market share. Intramodal competition based on unbundled network elements has taken an 8 percent market share.

EXHIBIT 18: MARKET STRUCTURE OF LOCAL TELEPHONE SERVICE:

ZIP CODES WITH COMPETITION



Source: Industry Analysis Division, *Local Telephone Competition: Status as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Tables 11, 12.

OTHER MEASURES OF MARKET POWER

For cable systems, the most frequently used measure of the extraction of value from consumers is the sale price of systems. When systems sell for a lot more than its cost to build them, the assumption is that entry barriers are preventing competition from driving down the price.[147] When systems can be built for a lot less than they are being sold, there must be something preventing entrants from coming into the field. The incumbent owners are clearly enjoying the benefits of the added value that barriers to entry are creating by selling at inflated prices.[148]

In the cable industry, entry is extremely difficult. Incumbents hold a franchise and they resist over-building with a vengeance.[149] Moreover, even if a potential entrant exists, the integrated nature of the industry denies that entrant access to programming, which is necessary to compete.

The best and most direct interpretation of Tobin's q in this case is that it represents a massive monopoly premium, earned by cable operators who possess market power. Exhibit 18 shows estimates of the transaction price for cable systems compared to estimates of reproduction costs. There is no doubt that there was a tremendous increase in q ratios after deregulation.

These numbers show that at the time of deregulation in 1984, the premium paid for systems was about $400. Tobin's q was about 1.6. This premium rose steadily until 1988, when systems were selling at $1500 more than their reproduction costs. Tobin's q had risen to 3 to 4. These figures were quite damning and the cable industry first tried to deny the fact that Tobin's q had grown dramatically, but finally was forced to fall back on efforts to justify the increase.[150]

During the regulated period of the 1990s, the premium declined. Price controls squeezed the monopoly profits. In 1994 the premium was about $1000 and Tobin's q declined to about 2.5. Since then, deregulation has driven the prices through the roof, with prices approaching $5,000 and premiums exceeding $4,000.

Actually these estimates of Tobin's q demonstrate an important principle of monopolies, duopolies or tight oligopolies. Economic theory tells us that they will only produce up to the point where marginal revenue equals marginal cost,[151] within a market, so it is a good bet that they will apply roughly the same principle across markets. Entities that discover they can extend market power to a new product space are going to lower their rates of profit.

The link between the market power to set prices results and the collection of monopoly rents can be seen by plotting the increase in real prices against Tobin's q (see Exhibit 19). Sales prices for cable systems have increased sharply, whenever prices are deregulated.

EXHIBIT 18: CABLE SYSTEM TOBIN'S q

YEAR	System Sale Price (a)	Reproduction Cost
1983	$1000	$645 (b)
1986	1300	400-700 (c)
1988	2000	500-600 (d)
1992	1700	700 (e)
1994	1900	500(f) - 700 (g) - 800 (h)
1900		
1998	2900	
1999	4000	
basic		500-700 (j)
interactive		2000 (j)
2000	5900	1300 – 1500 (f)
2001	4300(k)	

SOURCES:

a) Kagan Associates Inc., *Cable TV Master Database*, various issues, rounded to the nearest $100.

b) H. L. Vogel, *Entertainment Industry Economics* (Cambridge University Press, Cambridge, 1986).

c) Shooshan and Jackson, *Opening the Broadband Gateway: The Need for Telephone Company Entry Into the Video Services Marketplace*, October 1987.

d) Shooshan and Jackson, *Measuring Cable Industry Market Power*, March 2, 1990; Leland L. Johnson and David P. Reed, *Residential Broadband Services By Telephone Companies*? (Santa Monica, Rand, 1990).

e) David P. Reed, *Residential Fiber Optic Networks* (Artech House, Boston, 1992), Tables 5.3 and B.8.

f) Thomas Hazlett and George Bittlingmayer, *The Political Economy of Cable "Open Access"* (Joint Center, Working Paper 01-06, May 2001)

g) Johnson, Leland, and David P. Reed, *Residential Broadband Services By Telephone Companies*? (Santa Monica, Rand, 1990).

h) Bell Atlantic, *In the Matter of the Application of The Chesapeake and Potomac Telephone Company of Maryland and Virginia for Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, to Construct, Operate, Own and Maintain Facilities and Equipment to Provide a Commercial Video Dialtone Service within a Geographic Territory Defined by the Maryland and Virginia Portions of the Washington Local Access Transport Area, December 1994, Exhibit 3; U.S. West, In the Matter of the Application of U.S. West, Inc., for Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, to Construct, Operate, Own and Maintain Facilities and Equipment to Provide a Commercial Video Dialtone Service in Portions of Colorado Springs*.

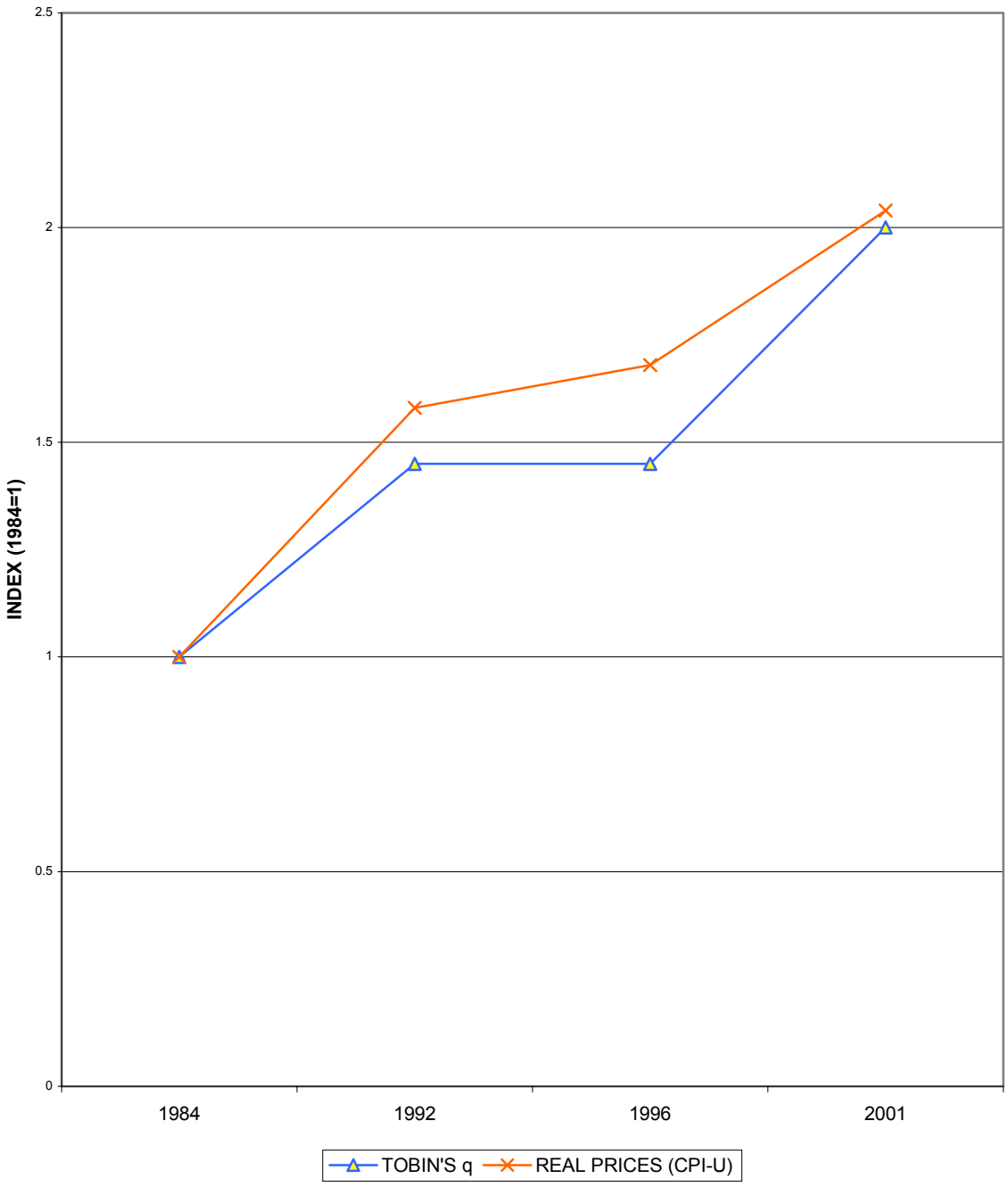
(i) These are widely reported prices paid per subscriber in the wake of the AT&T-MediaOne deal.

(j) Morgan Stanley Dean Witter, *Digital Decade,* April 6, 1999.

(k) Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming: Eight Annual Report, January 14, 2002, Table B-3. This estimate includes ATT/Comcast at $4500 per subscriber.

.

EXHIBIT 19: REAL PRICE INCREASES AND MONOPOLY RENTS (TOBIN'S q)



Sources: See Exhibits 2 and 18.

V. CONCLUSION

THE PERVASIVE PROBLEM OF MARKET POWER

The direct evidence on the weakness of competition between cable and satellite in the video market and cable and DSL in the high-speed Internet market should lead objective observers to expect to find the abuse of market power. While it can be argued that each of the measures of market power discussed above leaves something to be desired, when all of them point so clearly in the same direction, the obvious conclusion cannot be denied. There is a great deal of market power being exercised by cable operators at the point-of-sale in the multi-channel video programming distribution market.

The behavior in the high speed Internet access market reinforces these conclusions. After five years of build out and with almost three-quarters of the plant upgraded, cable systems are still essentially closed. To the extent that access is being granted, it is on terms and conditions that eviscerate the potential for content providers to compete with incumbent facility owners. Pricing patterns indicate strategic decisions and the exercise of market power.

The problem of market power in the industry is pervasive with a persisting virtual monopoly at the point of sale, substantial vertical integration between distribution and content, and concentration at the national level. Standing alone, each of the structural conditions merits strong concern; taken together, the combination of these three factors gives integrated cable operators a great deal of market power. Throughout the FCC's ongoing mass media and advanced telecommunications services proceedings and analysis, the three different sources of concern are intertwined.

A large national player, with market power at the point-of-sale, has a interest in controlling the flow of unaffiliated content, even if it does not own any of its own programming. Controlling the flow of programming enables it to deny programming to potential rivals. By denying the availability of inputs to rivals, it can reduce the likelihood of entry. Exercising its monopsony power, it can raise its rate of profit, relative to actual or potential competitors, and drive programmers to seek to recover their costs from smaller program purchasers.[152]

A large operator certainly can interfere with the ability of another operator to disseminate the same content for strategic reasons. When a large operator demands exclusivity so that potential or actual competitors cannot have access to it,[153] or explicitly demands to be given the lowest price,[154] or implicitly pushes the content provider to recover a disproportionate share of his costs from smaller operators who lack monopsony power,[155] he places the competitor at a disadvantage. The size of the entity is critical to the effectiveness of the demand, but that is what monopsony is all about.

Market power at the point-of-sale is also readily transmitted back up the value chain when cable operators become vertically integrated. Reduced competition at the point-of-sale enables them to favor their own content or hinder unaffiliated content in reaching the market, since unaffiliated programs have little or no chance of reaching consumers within the service areas that the cable operators dominate. Once they become vertically integrated, cable companies have incentives to withhold content from potential competitors in (downstream) distribution markets or to squeeze those competitors by driving up their costs.[156]

A substantial market share for dominant firms in the national content market is an independent problem that is reinforced by horizontal concentration and vertical integration. Given the nature of content production, with its high first-copy costs, producers need to achieve a large audience quickly to survive. By controlling a substantial number of eyeballs, cable operators can make or break content production. Exercising monopsony power as buyers, they can squeeze programmers by holding down what they pay or by insisting on sharing the profits (demanding equity stakes). Once they become vertically integrated, their incentive to squeeze out rivals is reinforced. The fewer the alternatives available for specialized inputs (creative producers), the easier their task of controlling the programming market.

THE REPEATED FAILURE OF CROSS-TECHNOLOGY COMPETITION

This is not the first time that cross-technology competition has failed to discipline market power in this industry. In the 1984 Cable Act, the Congress gave the FCC the authority to deregulate prices in competitive cable TV markets. Congress had been told that head-to-head competition between cable companies would grow as new cable operators overbuilt incumbents and competing technologies would add further competition.[157] The FCC determined that three over-the-air channels were enough to establish effective competition with cable in each community. As a result, cable systems serving about 80 percent of the country were deregulated.

Effective competition failed to materialize either from the entry of additional cable companies into the local franchise area or from other technologies. Over-the-air signals were extremely feeble competition. Numerous examples of discrimination in programming came to light. Cable prices exploded and public outcry ensued. In an effort to stave off legislation to re-regulate cable, the FCC reconsidered its three over-the-air rule and switched to six over-the-air stations as a standard. However, the pricing abuse was too great and the FCC's standard too weak to convince Congress that cable's market power would be checked.

By 1992, Congress had observed a continuing monopoly at the point-of-sale, with increasing concentration at the national level and growing vertical integration between programming and distribution. Congress re-regulated cable rates in 1992 and placed a range of "procompetitive" conditions on the industry, including a requirement that the Commission develop a structural limit on ownership (in the 1992 Cable Act).

During the second period of regulation, rate increases were diminished and the DBS satellite TV industry came into existence. Cable kept growing, adding approximately 7 million subscribers between the end of 1992 and 1995, boosting the total to about 62 million. Its penetration rate grew at a slightly higher rate during the regulated period than at any time after deregulation in 1984.

When Congress revisited the structure of the multichannel video market in the Telecommunications Act of 1996, it decided to relax rate regulation in anticipation of growing transmission competition from satellite and telephone companies. It cautiously left the ban on cross-ownership and the requirement for a horizontal limit in place.

Congressional caution was well grounded in contemporary economic theory and in the empirical reality of the cable TV industry. Empirically, one of the great disappointments of the 1996 Telecommunications Act has been the failure of competition from alternative technologies to break down the market power of the incumbents.[158] Congress devoted a

whole section of the law to telephone competition for cable through open video systems.[159] Open video systems are non-existent.[160] As this paper shows, cross-technology competition from satellite is weak as well.

PROMOTING INTRAMODAL COMPETITION IS A THE KEY TO COMPETITION FOR THE FORESEEABLE FUTURE

Thus the lynchpin for each of the court decisions that have remanded cable ownership rules and vacated cable-broadcast cross-ownership limits, and suggestions to relax or eliminate these structural limits involve the incorrect assumption that the cable industry faces meaningful competition from satellite. Cable operators need not fear loss of subscribers at the point of sale resulting from discrimination against non-affiliated programmers. Similarly, the suggestion that satellite or DSL technology can discipline cable market power at present does not stand close scrutiny.

Intramodal competition at the level of facilities – direct competition between similar facilities – is more effective than intermodal competition, but it is virtually non-existent and many analysts now believe that telecommunications and MVPD markets will not support vigorous facility competition. They are likely, at best to be duopolies. This is simply too little competition to discipline abusive pricing and strategic manipulation of supply.

Intramodal competition in the form of promoting competition between service providers over bottleneck and essential facilities appears to work better, but has never been tried in the cable industry and has been inconsistently implemented for the telephone companies. Unfortunately, the myth of intermodal competition is being used to drive policy farther from approaches that have a reasonable chance of achieving substantial competition in both the digital video and high-Internet access markets.

The fiction of intermodal competition helped convince the courts to overturn structural limits on cable ownership aimed at the video market. The FCC invoked this myth to refuse to require nondiscriminatory access to the advanced telecommunications services provided by cable systems. The same fiction is the basis for the FCC's proposals to abandon the obligation to provide nondiscriminatory access to the advanced telecommunications facilities owned by telephone companies.

The inevitable result of basing policies on competitive fictions, rather than facts, will be escalating consumer harm – high prices, poor service and retarded innovation.

ENDNOTES

[1] *Fox Television Stations, Inc., v. Federal Communications Commission*, 2002 WL 233650 (D.C. Cir.)), February 19, 2000 (hereafter, Fox v. FCC), p. 15.

[2] Fox v. FCC, p. 15,

> We acknowledge that the court should ordinarily defer to the Commission's predictive judgments, and we take the Commission's point about remedies. In this case, however, the Commission has not shown a substantial enough probability of discrimination to deem reasonable a prophylactic rule as broad as the cross-ownership ban, especially in light of the already extant conduct rules…

The Commission failed to consider competition from DBS, to justify its change in position from the *1992 Report*

[3] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Dockets Nos. 01-338, 96-98, 98-147, December 20, 2001 (hereafter, UNE Review)., para 26.

[4] "Application and Public Interest Statement," *In the Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (hereafter, Application), p. 66.

[5] Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154 (hereafter, Horizontal Limits Proceeding), September 21, 2001.

[6] Application, p. 93.

[7] Declaration of Janusz A. Ordover on Behalf of AT&T, (hereafter Ordover), p. 23.

[8] Ordover, p.20.

[9] Ordover, p. 4.

[10] Ordover, p. 10., see also Ordover, p. 46.

> First, because of the growing competitive threat from DBS and other alternative MVPDs, franchised cable systems have private incentives to provide good customer service and signal quality independent of the franchise renewal process

Ordover, p. 53.

> The demonstrated ability of customers to switch from cable to DBS and alternative providers is very important here. If these other MVPD distributors can garner share from the foreclosing firm by virtue of offering superior programming (and attractive rates), then even being foreclosed from a large MSO does *not* mean that a foreclosed programmer will lose a significant share of the distribution needed to maintain competitive viability

[11] Ordover, p. 59.

[12] Roston and Shelanski start the substantive discussion of their reply comments in the horizontal limits proceeding with a section (p.3) entitled "The Major Concern in this proceeding is the National Market for Video programming," In that section, they claim that "we assess the economic incentives that may give rise to concern about monopsony power from cable concentration on a national level and look at performance of the national programming market to see if there is any evidence of monopsony harm." Yet at the core of their discussion just three pages later, they are forced to rely on competition at the point-of-sale (i.e. the local market) as the critical disciplining force. In fact, they admit that the public policy issue of greatest concerned is most affected by the status of competition at the point of sale.

[13] *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*,, February 14, 2002, p. 36.

[14] *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, Report on Cable Industry Prices, February 14, 2001, p. 36.

[15] Pearce, George, The Dictionary of Modern Economics (MIT Press, Cambridge, 1984), p. 94.

> Cross Elasticity of Demand. The responsiveness of quantity demanded of one good to a change in the price of another good.
> Where goods i and j are substitutes the cross elasticity will be positive-i.e. a fall in the price of good j will result in a fall in the demand for good i as j is substituted for i. If the goods are complements the cross elasticity will be negative. Where i and j are not related, the cross elasticity will be zero.

Taylor, John, B., Economics (Houghton Mifflin, Boston, 1998), p. 59.

> A sharp decrease in the price of motor scooters or rollerblades will decrease the demand for bicycles. Why? Because buying these related goods becomes relatively more attractive than buying bicycles. Motor scooters or rollerblades are examples of substitutes for bicycles. A substitute is a good that provides some of the same uses or enjoyment as another good. Butter and margarine are substitutes. In general, the demand for a good will increase if the price of a substitute for the good rises, and the demand for a good will decrease if the price of a substitute falls.

Bannock, Graham, R.E. Banock and Evan Davis, Dictionary of Economics (Penguin, London, 1987).

> Substitutes. Products that at least partly satisfy the same needs of consumers. Products are defined as substitutes in terms of cross-price effects between them. If, when the price of records goes up, sales of compact discs rise, compact discs are said to be a substitute for records, because consumers can to some extent satisfy the need served by records with compact discs. This account is complicated by the fact that, when the price of an item changes, it affects both the REAL INCOME 01 consumers and the relative prices of different commodities. Strictly, one product is a substitute for another if it enjoys increased demand when the other's prices rises and the consumer's income is raised just enough to compensate for the drop in living standards caused (pp. 390-391).
> Cross-price elasticity of demand. The proportionate change in the quantity demanded of one good divided by the proportionate change in the price of another good. If the two goods are SUBSTITUTES (e.g. butter and margarine), this ELASTICITY is positive. For instance, if the price of margarine increases, the demand for butter will increase (p. 99).

[16] Report on Cable Prices, 2002, p. 11.

[17] Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition with Cable TV*, University of Chicago Graduate School of Business Working Paper (October 2001).

[18] Rosston and Shelanski (p. 20), dismiss this study on the grounds that the data precedes the advent of local-into-local, but we point out it also largely precedes the advent of digital cable, which has negated the effect of local into local.

[19] Ordover, p. 62, footnotes omitted.

[20] Goolsbee & Petrin, p. 11.

[21] Goolsbee and Petrin, p. 4.

[22] Goolsbee and Petrin, p. 27.

[23] Price Report, 2002

[24] Price Report, 2001, describes the DBS variable as the level of subscription. Price Report, 2002, uses the DBS dummy variable.

[25] The cluster variable was included in the 200 and 2001 Price reports. Its behavior contradicted the FCC theory. It hass been dropped from the 2002 report. The MSO size was included in the 2002 report. System size has been included in all three reports.

[26] Vertical integration was included in the 2002 report.

[27] Ordover, p. 24.

[28] Rosston and Shelanski, p. 8).

[29] Jason B. Bazinet, *The Cable Industry* (J.P. Morgan Securities, Inc., November 2, 2001), p. 4.

[30] Ordover, pp. 23-27.

[31] Boersma, Matthew, "The Battle for Better Bandwidth – Should Cable Networks be Open?," *ZDNet,* July 11, 1999.

[32] Bazinet, p. 9.

[33] Richard Bilotti, *The Digital Decade* (Morgan Stanley Dean Witter, April 6, 1999), p. 9.

[34] Bazinet, p. 1.

[35] *Cable Television,* March 1, 2002, p. 1.

[36] Bazinet, p. 24.

[37] Seventh Annual Report, para 66.

[38] Centeris puts this at 2 million. Morgan puts the figure at 2.5 million In the CU survey 11 percent of the respondents said they subscribe to both, which works out to about 1.8 million households.

[39] *Cable/Satellite Television Survey* (Lauer Research Inc, March 2002).

[40] Rosston and Shelanski, p. 19, ignore the bundling and tiering that pervades the cable industry and enhances its ability to price discriminate.

[41] Joseph P. Guiltinan, "The Price Bundling of Services: A Normative Framework," Journal of Marketing, 51: April (1987), at 75.

> Consider, for example, a case in which we have two products or services and can estimate the distributions of reservation prices (the maximum amounts buyers are willing to pay) for each product. By bundling the products together, we essentially create a new product. If the two products are independent in demand, some customers who would only buy one of these if they were priced individually will now buy both products. The reason is that the value these customers place on one product is so much higher than its price that the combined value of the two products exceeds the bundled price. In economic terminology, the consumer surplus (the amount by which the individual's reservation price exceeds the actual price paid) from the highly valued product is transferred to the less valued product.

[42] Pricing philosophy in the industry clearly exhibits an effort to capture consumer surplus. As an article in an industry journal pointed out just before deregulation (Celia Conrad, "Choosing Cable Programming Services," Cable TV and New Media, 4:9 (1986):

> If viewers can purchase one channel and watch a second channel for free, they never will pay the market value of the second channel. A more profitable alternative for the pay television operator would be to offer program type A on the first channel and program type B on the second, and then sell both channels as a package. At an appropriate price, consumers will purchase the package. Even if the costs of scrambling were minimal, the package selling strategy would be more profitable than selling each channel individually.
>
> The practice of bundling recognized that consumers have preferences not only for program types but also for program variety. For example, some consumers might pay $25 for service A only; $25 for service B only, but $37.50 for a bundle of both A and B. Bundling is like an insurance policy. Whatever occurs, the consumer can watch his or her preferred program. But package selling may be attractive even aside from its insurance policy attributes. With package selling, the profitability of carrying a program type depends not only on how much revenue it generates on its own, but also increases the total package's revenues.

[43] The pricing strategy was apparent to some industry observers, as a Cisco publication noted (Abe, George, *Residential Broadband* (Cisco Press, Macmillan Technical Publishing, 1997), p. 217.

> Cable MSO management apparently agrees it is necessary to get more from each subscriber. Since the passage of the Telecom Act of 96, cable operators have taken the opportunity to raise subscription rates more than twice as fast as the consumer price index, clearly not a strategy for getting new households.

[44] Mundy, Alicia, "The Price of Freedom," *MediaWeek,* March 29, 1999, p. 32.

> Congress has been moving at an unusual speed to pass a bill that would give DBS providers the right to beam local network signals to local subscribers …
>
> "It's not a cure-all," said Hartenstein, who has run DirectTV since its inception in 1990. For one thing, Hartenstein's business plan is not based on beaming local network signals to his customer base, soon expected to top 9 million. Instead, he is suggesting that subscribers buy new antennas to supplement their coverage. DirecTV is working with retailers to have the specialized antennas available at reduced prices. He calls this program "Distant/Terrestrial," meaning he sends you all the cable and movie channels you could dream of (for which he can charge), and you pick up the free network feeds with an extra antenna.
>
> Furthermore, Hartensteins' game plan does not include fighting for cable customers by undercutting cable prices. Analysts for the DBS and cable industries have figured out which indicate that the average American homeowner will cough up $30 per month for TV. Above that level, both camps believe, many consumers will bolt and run. Hartenstein seems determined to compete on quality and depth of service, not on price.

[45] In trying to explain away the contradictory finding that the cross-price elasticity between cable and satellite had the wrong sign (Report on Cable Prices, p. 11), the FCC suggested that the cable operators reporting DBS penetration numbers "is made up almost entirely of small operators, may not be representative of the response to DBS generally Note that the same represenativeness problem that is invoked to discredit the contrary finding of a wrong sign of the price elasticity would also call into question the substitution effect.

[46] Bazinet, p. 35.

[47] Bits, p. 29.. 31.

[48] Bits, p. 188.

[49] Spangler, Todd, "Crossing the Broadband Divide," *PC Magazine*, February 12, 2002 (noting pricing and service quality problems), Ashton, Doug, "The Future of Telecommunications Investment," *Columbia Institute for Tele-Information*, March 3, 2001 (noting lack of new services), Tim Horan, "Communications Services: Industry Restructuring," *Columbia Institute for Tele-Information*, March 3, 2001 (noting lack of competitors and lack of services), Bits, p. 15, 58, (noting service quality and lack of a killer application). Bits, p. 22.
[50] Bazinet, p. 35, Bits, pp. 127, 137.
[51] Jerry A. Hausman, J. Gregory Sidak, and Hal J. Singer, "Residential Demand for Broadband Telecommunications and Consumer Access to Unaffiliated Internet Content Providers," *Yale Journal on Regulation*, 18 (2001), p. 134.
[52] AT&T Canada Long Distance Services, "Comments of AT&T Canada Long Distance Services Company," before the *Canadian Radio-television and Telecommunications Commission*, Telecom Public Notice CRTC 96-36: Regulation of Certain Telecommunications Service Offered by Broadcast Carriers, February 4, 1997. The AT&T policy on open access after it became a cable company was first offered in a Letter to Chairman Bill Kennard, dated December 6, 1999, signed by David N. Baker, Vice President Legal & Regulatory Affairs; Mindspring Enterprises; James W. Cicconi, General Council and Executive Vice President, AT&T Corp.; and Kenneth S. Fellman, Esq., Chairman, FCC Local & State Government Advisory Committee. Virtually no commercial activity took place as a result of the letter, which was roundly criticized. Subsequently their policy was described in Goodman, Peter S., "AT&T Puts Open Access to a Test," *Washington Post,* November 23, 2000 (hereafter Goodman).
[53] Reply Comments of AT&T Corp. (CC Docket No. 98-147), filed October 16, 1998; "Comments of AT&T Corp. in Opposition to Southwestern Bell Telephone Company's Section 271 Application for Texas," *In the Matter of Application of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Texas*, Federal Communications Commission, CC Docket No. 00-4, January 31, 2000 (hereafter AT&T SBC).
[54] America Online Inc., "Open Access Comments of America Online, Inc.," before the Department of Telecommunications and Information Services, San Francisco, October 27, 1999 (hereafter, AOL). At the federal level, AOL's most explicit analysis of the need for open access can be found in "Comments of America Online, Inc.," *In the Matter of Transfer of Control of FCC Licenses of MediaOne Group, Inc. to AT&T Corporation,* Federal Communications Commission, CS Docket No. 99-251, August 23, 1999 (hereafter, AOL, FCC).
[55] Jerry A. Hausman, J. Gregory Sidak, and Hal J. Singer, "Residential Demand for Broadband Telecommunications and Consumer Access to Unaffiliated Internet Content Providers," *Yale Journal on Regulation*, 18 (2001).
[56] John B. Hayes, Jith Jayaratne, and Michael L. Katz, *An Empirical Analysis of the Footprint Effects of Mergers Between Large ILECS,* April 1, 1999, p. 1; citing "Declaration of Michael L. Katz and Steen C. Salop," submitted as an attachment to *Petition to Deny of Spring Communications Company L.P,* in Ameritech Corp. and SBC Communications, Inc., for Consent to Transfer of Control, CC Dkt. No. 98-141 (filed Oct. 15, 1998) and *Petition to Deny of Spring Communications Company L.P,* in GTE Corporation and Bell Atlantic Corporation for Consent to Transfer of Control, CC Dkt. No. 98-184 (filed Nov. 23, 1998).
[57] Sanford C. Bernstein and McKinsey and Company, *Broadband!*, January, 2000 (hereafter Bernstein); Merrill Lynch, AOL *Time Warner*, February 23, 2000 (hereafter, Merrill Lynch); Paine Webber, *AOL Time Warner: Among the World's Most Valuable Brands*, March 1, 2000 (hereafter, Paine Webber); Goldman Sachs, *America Online/ Time Warner: Perfect Time-ing*, March 10, 2000 (hereafter, Goldman Sachs).
[58] Earthlink, the first ISP to enter into negotiations with cable owners for access has essentially given up and is vigorously seeking an open access obligation, see *Ex Parte Letter from Earl W. Comstock and John W. Butler Regarding the Application of America Online, Inc. and Time Warner Inc. for Transfer of Control*, Federal Communications Commission, Docket No. CS 0030, October 18, 2000 (hereafter Earthlink); NorthNet.
[59] "Comments of the American Cable Association, *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Federal Communications Commission, CS Dkt. No. 01-290, December 3, 2001.
[60] Richard N. Langlois, "Technology Standards, Innovation, and Essential Facilities: Toward a Schumpeterian Post-Chicago Approach," in Jerry Ellig (Ed.), *Dynamic Competition and Public Policy: Technology, Innovations, and Antitrust Issues* (Cambridge: Cambridge University Press, 2001.

[61] Mark Cooper, "Open Access to the Broadband Internet: Technical and Economic Discrimination in Closed Proprietary Networks," *University of Colorado Law Review,* Fall 2000).

[62] Bernstein, pp. 18…21,

> Broadband access platforms are the anchor points for much of the value at stake and vehicles for accessing new revenue streams.
>
> However, the current set of alternatives for reaching customers with broadband connections is inadequate. At least for the time being, cable is closed, meaning that much of the value is, in effect, ceded to the platform rather than captured by the content/applications providers…
>
> Furthermore, access is currently a bottleneck, and access winners have the potential to leverage their privilege positioned to ensure long-term value creation.

[63] AT&T, pp. 7, 12 (Arguing that there were barriers to entry into physical facilities.)

> In the opinion of AT&T Canada LDS, the supply conditions in broadband access markets are extremely limited. There are significant barriers to entry in these markets including lengthy construction periods, high investment requirements and sunk costs, extensive licensing approval requirements (including the requirements to obtain municipal rights of way)… Under these circumstances, the ability for new entrants or existing facilities-based service providers to respond to nontransitory price increases would be significantly limited, not to mention severely protracted.

[64] AOL, FCC, p. 13

[65] Hausman, Sidak, and Singer, p.135.

[66] Hausman , Sidak and Singer, p. 156.

[67] Hausman, Sidak and Singer, p. 135.

[68] AT&T, 12.

> Each of these pronouncements made by regulators, policy makers and individual members of the industry reflects the strongly held view that access to the underlying facilities is not only necessary because of the bottleneck nature of the facilities in question, but also because it is critical for the development of competition in the provision of broadband services. AT&T Canada shares this view and considers the control exercised by broadcast carriers over these essential inputs is an important factor contributing to the dominance of broadcast carriers in the market for access services.

[69] AT&T, 9.

> By contrast, the telephone companies have just begun to establish a presence in the broadband access market and it will likely take a number of years before they have extensive networks in place. This lack of significant market share, however, is overshadowed by their monopoly position in the provision of local telephony services.
>
> In any event, even if it could be argued that the telephone companies are not dominant in the market for broadband access services because they only occupy a small share of the market, there are a number of compelling reasons to suggest that measures of market share are not overly helpful when assessing the dominance of telecommunications carriers in the access market.

[70] AT&T, p. 24

[71] AT&T, p. 1,

> Because there are and will be many more providers of content in the broadband market than there are providers of carriage, there always will be more service providers than access providers in the market. Indeed, even if all of the access providers in the market integrated themselves vertically with as many service providers as practically feasible, there would still be a number of service providers remaining which will require access to the underlying broadband facilities of broadcast carriers

[72] *Responses of AT&T to Ten Questions to Begin the Committee's Inquiry into State Broadband Policy,* House Committee on State Affairs, Austin, Texas, April 3, 2002, p. 7.

[73] Letter to Robert Pitofsky and William Kennard, June 7, 2000.

[74] AOL, FCC, p. 14. Another indication that the availability of alternative facilities does not eliminate the need for open access policy can be found in AOL's conclusion that the policy should apply to both business and residential customers. If ever there was a segment in which the presence of two facilities competing might alleviate the need for open access requirement, the business segment is it. AOL rejected the idea. *Id*. at 1-2).

[75] AT&T, p. 23

> To the extent that standards are developed for interfacing with broadband access services, the carriers who provide these services should not be permitted to implement any non-standard, proprietary interfaces, as this would be contrary to the development of an open network of networks. In addition, any new network or operational interface that is implemented by a broadband access provider should be made available on a non-discriminatory basis

[76]The FTC's enumeration of the ways in which the Time Warner/Turner/TCI merger was a threat to lessen competition are instructive for both the cable TV and the broadband Internet markets. The vertical integration and horizontal concentration would increase the incentive and ability to engage in both conduit discrimination and content discrimination (Time Warner/Turner/TCI, pp. 8).

> enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs, directly or indirectly (e.g., by requiring the purchase of unwanted programming). Through it's increased negotiating leverage with MVPDs, including through purchase of one or more "marquee" or "crown jewel" channels on purchase of other channels.
>
> enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs by raising barriers to entry by new competitors or to repositioning by existing competitors, by preventing such rivals from achieving sufficient distribution to realize economies of scale;
>
> denying rival MVPDs and any potential rival MVPDs of Respondent Time Warner competitive prices for Cable Television Programming Services, or charging rivals discriminatorily high prices for Cable Television Programming services
>
> Respondent time Warner has direct financial incentives as the post-acquisition owner of the Turner Cable Television Programming Services not to carry other Cable Television Programming Services that directly compete with Turner Cable Television Programming Services; and
>
> Respondent TCI has diminished incentives and diminished ability to either carry or invest in Cable Television Programming Services that directly compete with the Turner Cable Television Programming Services because the PSA agreements require TCI to carry Turner's CNN, Headline News, TNT and WTBS for 20 years, and because TCI, as a significant shareholder of Time Warner, will have significant financial incentives to protect all of Time Warner's Cable Television Programming

[77] Hausman, Sidak and Singer, p. 159.

[78] Hausman, Sidak and Singer, p. 159.

[79] AT&T NOI,

> This strategy entails setting the unbundled price of the basic local service and the price of the incremental cost of supplying the DSL service alone. In this scenario, the direct effect of the conduct is to squeeze out the competing suppliers of the enhanced service that might otherwise serve as attractive complements to the basic services offered by the incumbent local exchange carrier (LEC).
>
> Allowing incumbent LECs to bundle basic services with enhanced service provided over bottleneck facilities could also better enable them to squeeze out efficient potential competitors through non-price means – e.g. by offering lower quality monopoly bottleneck service to customers of their competitors, and by provider quicker or more complete disclosure of their network interface specifications and protocols to favored venders. That is so because bundling potentially 'covers up' discrimination

[80] AT&T, p. 15,

> The dominant and vertically integrated position of cable broadcast carriers requires a number of safeguards to protect against anticompetitive behavior. These carriers have considerable advantages in the market, particularly with respect to their ability to make use of their underlying network facilities for the delivery of new services. To grant these carriers unconditional forbearance would provide them with the opportunity to leverage their existing networks to the detriment of other potential service providers. In particular, unconditional forbearance of the broadband access services provided by cable broadcast carriers would create both the incentive and opportunity for these carriers to lessen competition and choice in the provision of broadband service that could be made available to the end customer.
>
> Telephone companies also have sources of market power that warrant maintaining safeguards against anticompetitive behavior. For example, telephone companies are still overwhelmingly dominant in the local telephony market, and until this dominance is diminished, it would not be appropriate to forebear unconditionally from rate regulation of broadband access services (

[81] AOL, p. 8

[82] John B. Hayes, Jith Jayaratne, and Michael L. Katz, *An Empirical Analysis of the Footprint Effects of Mergers Between Large ILECS,* April 1, 1999, p. 1; citing "Declaration of Michael L. Katz and Steen C. Salop," submitted as an attachment to *Petition to Deny of Spring Communications Company L.P,* in Ameritech Corp. and SBC Communications, Inc., for Consent to Transfer of Control, CC Dkt. No. 98-141 (filed Oct. 15, 1998) and *Petition to Deny of Spring Communications Company L.P,* in GTE Corporation and Bell Atlantic Corporation for Consent to Transfer of Control, CC Dkt. No. 98-184 (filed Nov. 23, 1998).

[83] Hausman, Sidak and Singer, pp. 160-161.

[84] Bernstein, p. 57

> Thus, the real game in standards is to reach critical mass for the platform without giving up too much control. This requires a careful balance between openness (to attract others to your platform) and control over standards

development (to ensure an advantaged value-capture position). Of course, the lessons of Microsoft, Cisco, and others are not lost on market participants, and these days no player will willingly cede a major standards-based advantage to a competitor. Therefore, in emerging sectors such as broadband, creating a standards-based edge will likely require an ongoing structural advantage, whether via regulatory discontinuities, incumbent status, or the ability to influence customer behavior.

[85] Northnet.

[86] Time Warner's Term Sheet and AT&T public statements about how it will negotiate commercial access after its technical trial give a clear picture of the threat to dynamic innovation on the Internet. The companies' own access policies reveal the levers of market power and network control that stand to stifle innovation on the Internet. Under the imposed conditions, the commercial space available for unaffiliated and smaller ISPs (where much innovation takes place) is sparse and ever shrinking.

[87] Time Warner Term Sheet,

> To the extent ISP wishes to offer any functionality as part of the Service which: (a) is outside the scope of the Network Architecture; (b) requires an Operator acquire equipment or software or implement a change in the way the Operator processes, TWC shall have the right to approve such new functionality, provided however that in the event TWC approves such functionality, ISP will be obligated to reimburse for TWC its direct, out-of-pocket costs in implementing such new functionality.

[88] Goodman,

> Founder Joe Pezzillo worries that the competitive gap could widen as broadband brings new business models. He envisions AT&T making deals with major music labels to deliver its own Internet radio, with AT&T providing the fastest connections to its partners and slower connections to sites like his. "Someone is not going to wait for our page to load when they can get a competitor's page instantly," Pezzillo said.
>
> AT&T says it has yet to formulate business models with partners, but the software the company has designed for the Boulder trial – demonstrated at its headquarters in Englewood, Colo. Last week – clearly includes a menu that will allow customers to link directly to its partners. Company officials acknowledge that AT&T's network already has the ability to prioritize the flow of traffic just as Pezzillo fears.
>
> "We could turn the switches in a matter of days to be able to accommodate that kind of environment," said Patrick McGrew, an AT&T manager working on the technical details of the Boulder trial.
>
> Though the Boulder trial is focused on technical issues alone, AT&T will study the way customers navigate the system as it negotiates with ISPs seeking to use its network…

[89] Hausman, Sidak and Singer, p. 159.

> [A] cable broadband provider will engage in conduit discrimination if the gain from additional access revenues from broadband users offsets the loss in content revenues from narrower distribution…
>
> To capture the gains from such discrimination, the vertically integrated cable provider must have a cable footprint in which to distribute its broadband portal service, either through direct ownership or through an arrangement to share the benefits of foreclosure with other cable providers.

[90] Hausman, Sidak and Singer, p. 156; "Comments of the American Cable Association, "In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition, Federal Communications Commission, CS Dkt. No. 01-290, December 3, 2001, p. 13 (hereafter ACA), provides the calculation for cable operators

> The major MSOs will be the clear winners in these transactions. MSOs granted exclusive distribution rights will have an opportunity to attract DBS subscribers with exclusive programming, resulting in increased subscriber revenues (a minimum of $40-$50 per subscriber) and increased system values (at least $3,500-$5,000 per subscriber).
>
> Where do ACA members fit into these transactions? Nowhere. ACA members operate locally, not regionally or nationally. In situations involving regional or national exclusive distribution rights, there is little incentive to carve out exceptions for smaller cable systems. For each small system subscriber lost under exclusivity, the vertically integrated program provider will likely lose revenue between $0.10 and $0.75 per month, depending on the service. In contrast, for each former DBS subscriber gained through regional or national exclusive program offerings, the MSO with exclusive distribution rights will gain all monthly revenue from that subscriber, plus increased system value. In economic terms, an external cost of this gain will be the cost to small cable companies and consumers of reduced program diversity.

[91] Rubinfeld and Singer, p. 567.

> *Hence, a cable broadband provider will engage in conduit discrimination if the gain for additional access revenues from broadband users offsets the loss in content revenues form narrower distribution.*
>
> What determines whether conduit discrimination will be profitable? Simply put, if a cable broadband transport provider that controls particular content only has a small fraction of the national cable broadband transport market, then that provider would have little incentive to discriminate against rival broadband transport providers *outside of*

its cable footprint. The intuition is straightforward: out-of-franchise conduit discrimination would inflict a loss on the cable provider's content division, while out of region cable providers would the primary beneficiaries of harm done to non-cable competitors.

[92] Hausman, Sidak and Singer, p. 156.

[93] "Comments of the Competitive Broadband Coalition," In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition, Federal Communications Commission, CS Dkt. No. 01-290, December 3, 2001, p. 11.

[95] Hausman, Sidak, Singer, p. 149.

It is possible that at some point in the future new technologies will emerge, or existing technologies will be refined, in such a way that they will compete effectively with cable-based Internet services… within the relevant two-year time horizon, neither DSL nor satellite-based Internet service will be able to offer close substitutes for cable-based Internet service. Hence, neither will be able to provide the price-disciplining constraint needed to protect consumer welfare.

[96] AT&T SBC Comments, pp. 9… 10… 11… 12,

..[I] f the incumbents were exempt from regulation merely because they are using their bottleneck facilities to provide advanced service, they could simply migrate captive local telephony customers to DSL before cable telephony or any other alternative to these monopoly services is available. Then the LECs could exploit their telephony monopoly over local customers without regulation, by means of pricing of local service to end-users as well as pricing of access to long distance providers, all under the rubric of "advanced services" offerings.

As both the Commission and Congress have recognized, high-speed data offerings constitute a crucial element of the market for telecommunications services, and, because of their importance, the manner in which they are deployed will also affect the markets for traditional telecommunications. Many providers have recognized the growing consumer interest in obtaining "bundles" of services from a single provider. Certainly SBC, with its $6 billion commitment to "Project Pronto" has done so. AT&T is prepared to compete, on the merits, to offer, "one-stop shopping" solutions. Competition, however, cannot survive if only a single carrier is capable of providing consumers with a full package of local, long distance, and xDSL services.

[97] AOL, FCC, p. 11.

[98] AOL, FCC, pp. 9-10.

[99] Merrill Lynch, pp. 37-38,

If the technology market has a communications aspect to it, moreover, in which information must be shared (spreadsheets, instant messaging, enterprise software applications), the network effect is even more powerful.

Bernstein, p. 26,

Thus, if the MSOs can execute as they begin to deploy cable modem services in upgraded areas, they have a significant opportunity to seize many of the most attractive customers in the coming broadband land grab. These customers are important both because they represent a disproportionate share of the value and because they are bell weathers for mass-market users.

[100] Hausman, Sidak and Singer, p. 164.

Due to the nature of network industries in general, the early leader in any broadband Internet access may enjoy a "lock-in" of customers and content providers – that is, given the high switching costs for consumers associated with changing broadband provider (for example, the cost of a DSL modem and installation costs), an existing customer would be less sensitive to an increase in price than would a prospective customer

[101] U.S. Department of Justice v. AT&T Corp. and MediaOne Group, Inc., Amended Complaint, May 26, 2000.

[102] AT&T, p. 12,

AT&T Canada LDS notes that narrowband access facilities are not an adequate service substitute for broadband access facilities. The low bandwidth associated with these facilities can substantially degrade the quality of service that is provided to the end customer to the point where transmission reception of services is no longer possible.

[103] Hausman, Sidak and Singer, pp. 135-148.

[104] Bernstein, p. 8

[105] Goldman Sachs, pp. 10…17

> AOL Time Warner is uniquely positioned against its competitors from both technology and media perspectives to make the interactive opportunity a reality. **This multiplatform scale is particularly important from a pricing perspective, since it will permit the new company to offer more compelling and cost effective pricing bundles and options than its competitors.** Furthermore, AOL Time Warner will benefit from a wider global footprint than its competitors…
> We believe the real value by consumers en masse will be not in the "broadband connection" per se, but rather an attractively packaged, priced, and easy-to-use service that will bundle broadband content as an integral part of the service.

[106] AT&T 12.

[107] Karen Brown, "Excite Deal is Derailed, AT&T Takes Hardest Hit, *Multichannel News*, December 10, 2001, "Excite@Home's 35 percent cut of subscriber fees to operate the service equaled roughly #13 to $14 monthly per subscriber. In contrast, Burke said Comcast could run the service for $7 to $8 per month.

[108] Thomas W. Hazlett and George Bittlingmayer, *The Political Economy of Cable "Open Access"* (Joint Center, Working Paper 01-06, May 2001, pp. 3… 4.

[109] Hazlett and Bittlingmayer, p. 17.

[110] stry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Table 9 (hereafter High-Speed Access), Table 6.

[111] Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990), p. 4. Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985), p. 5, presents a similar view.

[112] Scherer and Ross, p. 4.

[113] Scherer and Ross, p. 4.

[114] Scherer and Ross, p. 5.

[115] Scherer and Ross, p. 5.

[116] Scherer and Ross, p. 15.

[117] Scherer and Ross, p. 18.

[118] Scherer and Ross, p. 20.

[119] Scherer and Ross, pp. 17…18.

[120] Scherer and Ross, Chapter 18.

[121] Scherer and Ross, p. 16…17

[122] Scherer and Ross, pp. 53-54. Summarizing the literature, Scherer and Ross develop a useful list of these characteristics as follows:

> Structural Criteria: The number of traders should be at least as large as scale economies permit,
> There should be no artificial inhibitions on mobility and entry; there should be moderate and price-sensitive quality differentials in products offered.
> Conduct Criteria: Some uncertainty should exist in minds of rivals as to whether price initiatives will be followed; Firms should strive to attain their goals independently, without collusion; There should be no unfair, exclusionary, predatory, or coercive tactics; Inefficient suppliers and customers should not be shielded permanently; Sales promotions should be informative, or at least not misleading; There should be no persistent, harmful price discrimination.
> Performance Criteria: Firms' production and distribution operations should be efficient and not wasteful or resources; Output levels and product quality (that is variety, durability, safety, reliability, and so forth) should be responsive to consumer demands; Profits should be at levels just sufficient to reward investment, efficiency, and innovation; Prices should encourage rational choice, guide markets toward equilibrium, and not intensify cyclical instability; Opportunities for introducing technically superior new products and processes should be exploited; Promotional expenses should not be excessive.; Success should accrue to sellers who best serve consumer wants

[123] J. W. Friedman, Oligopoly Theory (Cambridge: Cambridge University Press, 1983), pp. 8-9.

[124]U.S. Department of Justice, Merger Guideline, revised, 1997.

[125] Shepherd, p. 389, gives the following formulas for the Herfindahl-Hirschman Index (HHI) and the Concentration Ratio (CR):

$$H = \sum_{i=1}^{n} S_i^2$$

$$I = \sum_{i=1}^{m}$$

$$CR = \sum_{i=1}^{m} S_i$$

m i = 1

where

n = the number of firms

m= the market share of the largest firms (4 for the 4 firm concentration ratio)

S_i = the share of the ith firm.

[126] Shepherd, p. 4.

[127] Horizontal Merger Guidelines, at section 0.1.

> The rule of thumb reflected in all iterations of the Merger Guidelines is that the more concentrated an industry, the more likely is oligopolistic behavior by that industry.... Still, the inference that higher concentration increases the risks of oligopolistic conduct seems well grounded. As the number of industry participants becomes smaller, the task of coordinating industry behavior becomes easier. For example, a ten-firm industry is more likely to require some sort of coordination to maintain prices at an oligopoly level, whereas the three-firm industry might more easily maintain prices through parallel behavior without express coordination.

[128] Rosston and Shelanski misstate the operative problem of market power (p. 7). They insist on unilateral action when they argue, "if the cable operator were not large enough to dictate the nature of programming for the market as a whole, then the large cable operator would face competition." This ignores the role of coordinated or parallel strategic actions. Lawrence Sullivan and Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook,* Hornbook Series (West Group, St. Paul, 2000), pp. 531 describe the general issue as follows.

> They go on to note the mechanisms that might be used and the usefulness of the HHI in this regard.
>
> Oligopoly conditions may or may not require collusion that would independently violate Section 1 of the Sherman Act. A supracompetitive price level may be maintained through price leadership (usually the leader is the largest firm), through observance of a well-established trade rule (e.g., a convention of a 50 percent markup in price among competing retailers), or through strategic discipline of nonconforming members of the industry…
>
> To the extent that one or very few members of a concentrated industry have much higher market shares than other members, the opportunities for strategic disciplining may expand… The expanded ability of the larger firm to coerce price discipline is reflected in the Herfindahl-Hirschman Index (HHI), which will assign a high concentration index to an industry with a very large participant. An industry with the same number of participants, each of them roughly equal in size, will have a lower index.

Lawrence Sullivan and Warren S. Grimes, describe the DOJ approach as follows pp. 596-597:

> The coordination that can produce adverse effects can be either tacit or express. And such coordination need not be unlawful in and of itself. According to the 1992 Guidelines, to coordinate successfully, firms must reach terms of interaction that are profitable to the firms involved and be able to detect and punish deviations. The conditions likely to facilitate these two elements are discussed separately, although they frequently overlap.
>
> In discussing how firms might reach terms for profitable coordination, the Guidelines avoid using the term "agreement," probably because no agreement or conspiracy within the meaning of Section 1 of the Sherman Act is necessary for the profitable interaction to occur. As examples of such profitable coordination, the Guidelines list "common price, fixed price differentials, stable market shares, or customer or territorial restrictions." Sometimes the facilitating device may be as simple as a tradition or convention in an industry.

[129] Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981. Interestingly, the first economic text cited by Landes and Posner (at note 6) was the 1980 edition of Scherer and Ross.

[130] Horizontal Limit Proceeding, para. 63

[131] Scherer and Ross, at 70… 71.

[132] Scherer and Ross, at 70… 71.

[133] W. Kip Viscusi, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust (*MIT Press, Cambridge, 2000), p. 149.

[134] Scherer and Ross, p. 416 .

[135] Scherer and Ross, at 415... 416.

As a surrogate, researchers have chosen diverse profitability measures that can be used, with varying degrees of reliability, as proxies for the evaluation of price above marginal cost.
A good long-run approximation to the Lerner index is the ratio of supra-normal profits to normal cost. This is approximated by the ratio:

$$\pi_S = \frac{\text{Supra-normal profit}}{\text{Sales revenue}}$$

where supra-normal profit = sales revenue – noncapital costs – depreciation – (total capital x competitive cost per unit of capital).

Second-best surrogates falling into three categories.

One is the accounting rate of return on stockholders' equity:

$$\pi_E = \frac{\text{Accounting profits to stockholders}}{\text{Book value of stockholders equity}}$$

Or on capital:

$$\pi_E = \frac{\text{Accounting profits + interest payments}}{\text{Total Assets}}$$

[136] FCC, Seventh Annual Report, p. 20, notes that cable operators in only 330 communities have been granted status as effectively competitive on the basis of overbuilding.
[137] FCC, Eighth Annual Report, Table C-1.
[138] Paul Kagan Associates, *Major Cable TV System Clusters*, 1998.
[139] FCC, Report on Cable Industry Prices, p. 31.
[140] FCC, Seventh Annual Report, p. 20.
[141] FCC, Seventh Annual Report, p.34, notes increasing urban subscribers, but figure show that satellite is still disproportionately rural.
[142] Rosston and Shelanski (p. 23), give a hypothetical local market with a cable firm having an 80 percent market share and satellite having 20 percent in making appoint about the impact of concentration in national markets. They never discuss the local HHI, which would be 6800. This meets the antitrust definition of a monopoly.
[143] Bits, p. 21.
[144] Industry Analysis Division, *High-Speed Services for Internet Access: Subscribership as of June 30, 2001* (Common Carrier Bureau, Federal Communications Commission, February 2002), Table 9 (hereafter High-Speed Access),
[145] Jason Bazinet, *The Cable Industry* (J.P. Morgan Equity Research, November 2, 2001), Figure 36 (hereafter, Cable).
[146] The role of intermodal competition in local telephony raised in the NPRM, paras. 24-28, is small.
[147] Direct estimates of price cost margins are virtually non-existent. Robert Rubinovitz, Market Power and Price Increases for Basic Cable Service Since Deregulation, (Economic Analysis Regulatory Group, Department of Justice, August 6, 1991) finds that about half of the price increases since 1984 are due to the exercise of market power.
[148] Formally, the ratio is called Tobin's q and it is represented as the ratio of the sales price to the reproduction cost of the assets. This measure has been used for the past decade in the cable industry. In particular, it was used by telephone companies in arguing that they should be allowed to enter the cable TV business, see Shooshan and Jackson, Measuring Cable Market Power: Recent Developments, December 1988; S. J. Grossman, On the Misuse of Tobin's Q To Measure Monopoly Power, February 26, 1990.
[149] Senate Committee Report at 13-14; House Committee Report at 45; Noam, 1984, op. cit., at 15.
[150] Shooshan and Jackson, S. J. Grossman, On the Misuse of Tobin's Q To Measure Monopoly Power, February 26, 1990; Paul W. MacAvoy, *Tobin's q and the Cable Industry's Market Power,* February 28, 1990
[151] Scherer and Ross, pp. 21…22; Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981.
[152] All of the industry experts incorrectly equate the simple economics of program production with the political economy of market structure.[152] For example, Rosston and Shelanski (p. 6) argue "the incentive of cable operators to act monopsonistically is further weakened by the fact that programs are non-rivalrous goods. One operator's distribution of a program does not interfere with the ability of another operator to disseminate the same program."

[153] See comments of the Consumer Federation of America, et al, Horizontal Limits Proceeding, p. 102-105, 124-139, Consumer Federation of America Reply Comments, pp. 46-56.
[154] See comments of the Consumer Federation of America, et al, Horizontal Limits Proceeding, p. 102-105, 124-139, Consumer Federation of America Reply Comments, pp. 46-56.
[155] See comments of the Consumer Federation of America, et al, Horizontal Limits Proceeding, p. 102-105, 124-139, Consumer Federation of America Reply Comments, pp. 46-56.
[156] See comments of the Consumer Federation of America, et al, Horizontal Limits Proceeding, p. 102-105, 124-139, Consumer Federation of America Reply Comments, pp. 46-56.
[157] "Testimony of Thomas Wheeler, President of the National Cable Television Association, " before the *Subcommittee on Communications of the Committee on Commerce, Science and Transportation*, United States Senate, June 21, 1989, pp. 4-5.

> Any analysis of cable ownership issues must begin with the fact that cable systems have developed as local monopolies. The premise of the 1984 Act was that cable would develop in a competitive market. Many legislators may have relied upon the promise of the cable industry that:
> "A consumer will have a couple of choices of cable companies. There will be two cable wires running down the street." (citing Testimony of Preston R. Padden, President Association of Independent Television Stations, Inc." before the *Subcommittee on Communications, Committee on Commerce Science and Transportation*, United States Senate, February 16-17, 1983) pp. 126-127.
> Other legislators likely relied on the anticipation that cable would face competition from emerging technologies such as direct broadcast satellite.
> With the 20/20 vision of hindsight, it is now clear that there is no competition -- no head to head cable competition, and no effective competition from other media.

[158] This section is drawn from the Mark Cooper and Gene Kimmelman, *The Digital Divide Confronts the Telecommunications Act of 1996,* February 1999.
[159] Title II, part 5.
[160] Federal Communications Commission, *In the Matter of Annual Assessment of Competition inMmarkets for the Delivery of Video Programming*, Fifth Annual Report, Appendix C.